

Introduction

Included in this section are descriptions and summaries of the annual state budget development process in Massachusetts. To better illustrate the state's budget objectives, we include summaries of the state's organization, fund structure, budget development processes and, finally, the particular factors and challenges affecting next year's budget for fiscal year 2015. Graphs and tables are provided to help illustrate many of the trends and factors affecting the state budget. Also included within this document is a user guide and glossary to assist in navigating this budget document. We encourage budget readers to visit our online website at www.mass.gov/budget.

Serving as a blueprint for the activities and obligations of the year, the state budget reflects the Commonwealth's collective judgment about state government's role in our society, obligations to serve its people and strategic investments to secure its future prosperity. Each program or line-item represents a critical service, program or responsibility that the state will perform or provide to families and individuals throughout the course of the year.

The Patrick Administration's FY 2015 budget is a balanced, responsible budget. It reflects the continuing financial challenges confronting Massachusetts, along with every other state, as we continue to recover from the unprecedented impact of the 2008-09 economic recession. Despite continued improvement in revenue growth in FY 2015, the state's revenue is not keeping pace with the rate of growth for costs in core services such as health care, safety net programs, education, public safety and transportation. The Administration's budget once again reflects difficult choices and fundamentally changes the way we do business across an array of government programs, services and operations. This budget relies on a responsible amount of one-time resources and a modest amount of new revenue, which will assist in preserving crucial state services while maintaining our nationally-recognized fiscal standing.

In addition, the FY 2015 budget invests strategically in a number of areas of state government: funding for public education to help close the achievement gap, controlling growth in health care costs in order to preserve our nation-leading access to affordable health insurance, job creation, addressing youth and urban violence, preparing for climate change realities and improving the state's reentry services for inmates leaving jails and prisons. The Patrick Administration is committed to protecting these investments and making difficult choices today that will allow us to uphold our responsibilities to future generations and position us for growth in the future.

The following sections describe the particular challenges facing the state in developing the FY 2015 budget and highlight the measures proposed to bring fundamental change and innovation to the way the state does business.

Massachusetts Government Structure

The government of the Commonwealth is divided into three branches: the Executive branch, the bicameral Legislature consisting of the House of Representatives and the Senate and the Judiciary.

Executive Branch

Chief Elected Positions

Governor

The Governor is the chief executive officer of the Commonwealth.

Lieutenant Governor

The Lieutenant Governor is elected along with the Governor. The two work closely together to address important day to day administrative functions of the Commonwealth.

Executive Council

Also referred to as the "Governor's Council," this body consists of eight members who are elected to two-year terms in even-numbered years. The Executive Council is responsible for the confirmation of certain gubernatorial appointments, particularly judges, and must approve all warrants (other than for debt service) prepared by the Comptroller for payment by the State Treasurer.

Appointed Positions

Governor's Cabinet

The Governor's Cabinet is comprised of eight gubernatorial appointees who assist the Governor in administration and policy making. Each cabinet secretary serves as the chief executive of their respective executive office.

The eight Cabinet Secretariats are:

- Executive Office for Administration and Finance;
- Executive Office of Education;
- Executive Office of Energy and Environmental Affairs;
- Executive Office of Health and Human Services;
- Executive Office of Housing and Economic Development;
- Executive Office of Labor and Workforce Development;
- Executive Office of Public Safety and Security; and
- Massachusetts Department of Transportation

Secretary of Administration and Finance

The Secretary of Administration and Finance is the Governor's chief fiscal officer. The activities of the Executive Office for Administration and Finance fall within six broad categories:

- Administrative and fiscal supervision, primarily the implementation of the Commonwealth's annual budget and monitoring of all agency expenditures during the fiscal year in accordance with published long-term fiscal policies;
- State tax law enforcement and collection of tax revenues through the Department of Revenue for remittance to the State Treasurer;

- Human resource management, the administration of the state personnel system, civil service system and employee benefit programs and negotiation of collective bargaining agreements with certain members of the Commonwealth's public employee unions;
- Capital facilities management, coordination and oversight of the construction, management and leasing of all state facilities;
- State 5-year capital plan development and implementation, including state debt affordability policies; and
- General government administration, including operational services and information technology services.

Of note, the Secretary of Administration and Finance serves as Chairperson of the Commonwealth Health Insurance Connector Authority, co-chairs the Massachusetts Life Sciences Center and serves as a member of numerous other state boards and commissions.

Secretary of Education

The Secretary of Education directs the Executive Office of Education and works closely with the Commonwealth's education agencies – Department of Early Education and Care, Department of Elementary and Secondary Education, Department of Higher Education and the University of Massachusetts system - while serving as a voting member of the governing board of all four education agencies. The Secretary is the Governor's top advisor on education and helps shape the Commonwealth's education reform agenda, including closing the achievement gap.

Secretary of Energy and Environmental Affairs

The Secretary of Energy and Environmental Affairs manages the only state Cabinet-level office in the country that oversees both environmental and energy agencies. The Secretary develops and implements policies that safeguard public health from environmental threats, preserve the natural resources of the Commonwealth and ensure affordable and clean energy across Massachusetts.

Secretary of Health and Human Services

The Secretary of Health and Human Services administers the largest secretariat of the Commonwealth and works to achieve the highest levels of health and well-being for all residents of Massachusetts. As the Governor's top health care advisor, the Secretary plays an intricate role in developing health care cost containment strategies.

Secretary of Housing and Economic Development

The Secretary of Housing and Economic Development is the Governor's chief economic development and housing advisor and cabinet member, and is responsible for helping achieve the Governor's top priorities, including strengthening and accelerating our economic recovery by supporting job creation in every region of the state. The Secretary oversees the Commonwealth's business development, housing and community development and consumer affairs agencies.

Secretary of Labor and Workforce Development

The Secretary of Labor and Workforce Development enhances the quality, diversity and stability of the Commonwealth's workforce. This is done through workforce training, providing temporary assistance when employment is interrupted and promoting labor-management partnerships. The Secretary also manages the Joint Task Force on the Underground Economy and Employee Misclassification, working with state officials across state government to combat workplace fraud and protect exploited workers.

Secretary of Public Safety and Security

The Secretary of Public Safety and Security is responsible for the policy development and budgetary oversight of secretariat agencies, independent programs and several boards which aid in crime prevention, homeland security preparedness, youth violence prevention and ensuring the safety of residents and visitors in the Commonwealth.

Secretary of Transportation

The Secretary of Transportation leads an organization that operates with a single mission: to provide a safe, reliable and efficient transportation network for residents of the Commonwealth. The Secretary chairs a five-member Board of Directors appointed by the Governor with expertise in transportation, finance and engineering, and oversees four divisions: Highway, Mass Transit, Aeronautics and the Registry of Motor Vehicles (RMV).

State Comptroller

The State Comptroller is responsible for administering and ensuring lawful and reasoned accounting policies and practices. Among the Comptroller's responsibilities are the publication of official financial reports, the management of the state accounting system and the oversight of fiscal management functions within all state agencies and departments. The Comptroller is appointed by the Governor for a term coterminous with the Governor's and may be removed by the Governor only for just cause.

The annual financial reports of the Commonwealth, single audit reports and any rules and regulations published by the Comptroller must be reviewed by an advisory board. This board is chaired by the Secretary of Administration and Finance and includes the State Treasurer, the Attorney General, the State Auditor, the Chief Administrative Justice of the Trial Court and two persons with relevant experience appointed by the Governor for three-year terms. The Commonwealth's audited annual reports include financial statements on both the statutory basis of accounting (the Statutory Basis Financial Report, or SBFR) and the General Accepted Accounting Principles (GAAP) basis (the Comprehensive Annual Financial Report, or CAFR).

Elected Constitutional Officers

Treasurer and Receiver-General

More commonly referred to as the State Treasurer, this individual has four primary statutory responsibilities:

- Collection of all state revenues, with the exception of agency-held funds;
- Management of both short-term and long-term investments of Commonwealth funds (excluding state employee and teacher pension funds), including all cash receipts;
- Disbursement of Commonwealth monies and oversight of reconciliation of the state's accounts; and
- Issuance of almost all debt obligations of the Commonwealth, including notes, commercial paper and long-term bonds.

In addition to these responsibilities, the State Treasurer serves as Chairperson of the Massachusetts Lottery Commission, the State Board of Retirement, the Pension Reserves Investment Management Board, the Massachusetts Water Pollution Abatement Trust and the Massachusetts School Building Authority. The State Treasurer also serves as a member of numerous other state boards and commissions, including the Municipal Finance Oversight Board.

Secretary of the Commonwealth

The Secretary of the Commonwealth, commonly referred to as the Secretary of State, is responsible for collection and storage of public records and archives, securities regulation, state elections, administration of state lobbying laws and custody of the seal of the Commonwealth.

Attorney General

The Attorney General is the chief lawyer and law enforcement officer of the Commonwealth of Massachusetts. The Attorney General represents the Commonwealth in all legal proceedings in both the state and federal courts, including defending the Commonwealth in actions in which a state law or

executive action is challenged. The office also brings actions to enforce environmental and consumer protection statutes, among others, and represents the Commonwealth in public utility and automobile rate-setting procedures. The Attorney General works in conjunction with the general counsels of the various state agencies and executive departments to coordinate and monitor all pending litigation.

State Auditor

The State Auditor provides independent and objective evaluations of the Commonwealth's financial and operational activities. The State Auditor is charged with improving the efficiency of state government by auditing the administration and expenditure of public funds and reporting the findings to the public. The State Auditor reviews the activities and operations of approximately 750 state entities and verifies contract compliance of private vendors doing business with the Commonwealth.

District Attorneys

The 11 elected Massachusetts District Attorneys and their combined staffs of 1,500 employees, including 700 prosecutors and 250 victim-witness advocates, are responsible for prosecuting approximately 300,000 cases annually.

State Sheriffs

The 14 elected Massachusetts State Sheriffs have various county-based responsibilities, including law enforcement, the care and custody of inmates and detainees, judicial services, transportation of prisoners, recidivism, officer training and inmate reentry programming.

Legislative Branch

The Legislature (officially called the General Court) is the bicameral legislative body of the Commonwealth, consisting of a 40-member Senate and a 160-member House of Representatives. Members of the Senate and the House are elected to two-year terms in even-numbered years. Each General Court meets for a two-year period. January of 2013 marked the start of the 188th General Court, which runs through January of 2015. The joint rules of the House and Senate require all formal business to be concluded by the end of July in even-numbered years and by the third Wednesday in November in odd-numbered years. The two legislative branches work concurrently on pending laws brought before them.

Lawmaking begins in the House or Senate Clerk's office where petitions, accompanied by bills, resolves, etc., are filed and recorded in a docket book. The clerks number the bills and assign them to appropriate joint committees. There are over 20 of these committees, each responsible for studying the bills which pertain to a specific area (i.e., taxation, education, health care, insurance, etc.), and each committee is composed of senators and representatives.

The standing committees schedule public hearings for the individual bills, which afford residents, legislators and lobbyists the opportunity to express their views. Committee members meet at a later time in executive session to review the public testimony and discuss the merits of each bill before making their recommendations to the full membership of the House or Senate. The committee then issues its report, recommending that a bill "*ought to pass*", "*ought not to pass*" or "*as changed*" and the report is submitted to the Clerk's office.

All legislation proposing an increase in taxes or a new tax must originate within the House of Representatives. Once a tax bill is originated by the House and forwarded to the Senate for consideration, the Senate may amend it. All bills are presented to the Governor for approval or veto. The Legislature may override the Governor's veto of any bill by a two-thirds vote of each house. The Governor also has the power to return a bill to the chamber of the Legislature in which it was originated

with a recommendation that certain amendments be made. Such a bill is then brought before the Legislature and is subject to amendment or re-enactment, at which point the Governor may still veto the bill but has no further right to return the bill with a recommendation to amend.

Judicial Branch

The judicial branch of state government is composed of the Supreme Judicial Court, the Appeals Court and the Trial Court. The Supreme Judicial Court has original jurisdiction over certain cases and hears appeals from both the Appeals Court, which is an intermediate appellate court, and in some cases, directly from the Trial Court. The Supreme Judicial Court is authorized to render advisory opinions on certain questions of law to the Governor, the Legislature and the Governor's Council. Judges of the Supreme Judicial Court, the Appeals Court and the Trial Court are appointed by the Governor, with the advice and consent of the Governor's Council, to serve until the mandatory retirement age of 70 years.

Independent Authorities and Agencies

The Legislature has established a number of independent authorities and quasi-public agencies within the Commonwealth, the budgets of which are not included in the Commonwealth's annual budget. These include the Commonwealth Connector Authority, Massachusetts Bay Transportation Authority (MBTA), Massachusetts School Building Authority (MSBA), individual Regional Transit Authorities and other entities. Budgetary information can be requested directly from these agencies.

Local Government

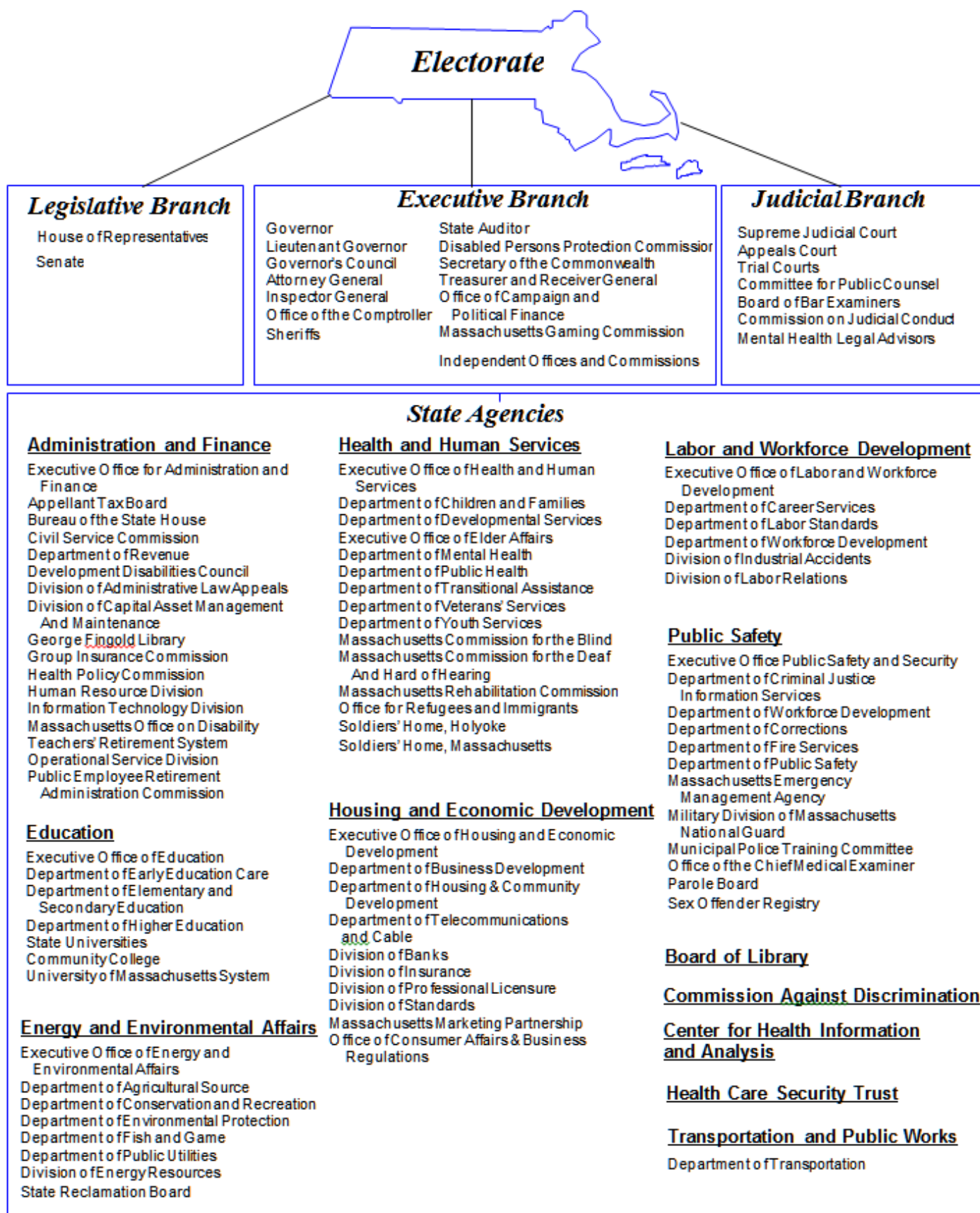
All territory in the Commonwealth lies within one of the 351 incorporated cities and towns that exercise the functions of local government, which include public safety, fire protection and public construction. Cities and towns or established regional school districts provide elementary and secondary education. In addition to schools, various local and regional districts administer water, wastewater and certain other governmental functions. Cities are governed by one of many nuanced variations of the mayor-and-council or manager-and-council form. Most towns place executive power in a board of three or five selectmen elected to one or three-year terms, and they retain legislative powers in the voters themselves, who assemble in periodic open or representative town meetings.

Municipal revenues consist of taxes on real and personal property, distributions from the Commonwealth under a variety of programs and formulas, local receipts (including motor vehicle excise taxes, local option taxes, fines, licenses and permits, charges for utility and other services and investment income) and appropriations from other available funds (including general and dedicated reserve funds). Because property tax levies are limited by Proposition 2½, an initiative petition approved by the voters in 1980, local governments have become increasingly reliant on distribution of revenues from the Commonwealth to support local programs and services (commonly known as "local aid"). The amount of local aid varies significantly among municipalities.

The cities and towns of the Commonwealth are organized into 14 counties; county government has been abolished in seven of those counties. The county governments that remain are responsible principally for the operation of courthouses and registries of deeds. Where county government has been abolished, the functions, duties and responsibilities of the government have been transferred to the Commonwealth, including all employees, assets, valid liabilities and debts.

Organizational Chart

The following organizational chart identifies the present structure of state government and its constituent agencies.



Overview of the Operating Budget Process

The annual budget is a declaration of the Commonwealth's priorities, given available resources, and a statement on how to allocate the resources to best operate programs and services and meet long-term liabilities.

Developing the annual operating budget is a lengthy process that involves all three branches of government, hundreds of agencies and thousands of stakeholders and residents.

- The Governor presents his budget recommendation to the Legislature.
- The House of Representatives and the Senate separately review the Governor's budget and develop their own recommendations.
- The House of Representatives and the Senate work together to reconcile their budgets and send the final bill to the Governor, who then signs the budget into law, either in full or in part.

The Constitution and Budget Related Laws

The *fiscal year* is a commonly used term to describe an annual budgeting period. State fiscal years start in one calendar year and end in the next. For example, fiscal year 2015 extends from July 1, 2014 to June 30, 2015. In a typical year, state agencies have the authority to spend funding provided for a fiscal year over a 14-month period, after accounting for the two month "accounts payable" period through August during which final payments are reconciled and made for costs incurred before June 30.

The budget planning process for any fiscal year begins before the end of the previous fiscal year. For example, planning for the FY 2015 budget began in July 2013. State agencies develop their budget implementation plans for the current fiscal year with a consideration of "out-years" as well, projecting the costs of current state employees, programs and services for the following fiscal year.

The Massachusetts State Constitution and General Laws outline and govern the budgeting process. The Massachusetts Constitution requires the Governor to present a budget to the Legislature within three weeks of the beginning of the new session in January, which this year is January 22, 2014. State finance law (Chapter 29 of the Massachusetts General Laws) requires the Legislature and the Governor to approve a balanced budget for each fiscal year. In other words, the Commonwealth cannot spend more than it receives in revenue during any single year. During the fiscal year, the Governor cannot approve supplementary appropriation bills that would result in an unbalanced budget.

Funds for the Commonwealth's programs and services must be appropriated by the Legislature each fiscal year. The final budget is a law known as the General Appropriations Act (GAA). The GAA specifies how agencies and departments may spend their appropriations and allocates exact dollar amounts authorized for a specific period and purpose. The budget also lists major revenue assumptions and reflects the most up-to-date projections for the total amount of resources that can be budgeted against from tax collections, reimbursements to the state from the federal government, and other revenues (fees, penalties) that are collected by state agencies.

Developing Next Year's Operating Budget: FY 2015 General Appropriations Act

FY 2015 Planning

| | |
|---|--|
| Department Planning & Secretariat Review | Department and agency staff review their policies and programs, develop spending plans and submit budget requests to their respective Cabinet secretary for review. The Cabinet Secretaries evaluate the requests and develop a secretariat-wide budget. |
|---|--|

| | |
|-----------------------|---|
| (July-September 2013) | Secretariats and agencies submit FY 2014 spending plans to A&F. Independents, the judiciary and constitutional officers also submit spending plans. |
|-----------------------|---|

| | |
|------------------------------|---|
| Formal Budget Request | Secretariats and agencies submit FY 2015 spending plans to A&F. Secretariats are assigned a spending cap by the Executive Office for Administration and Finance (A&F) based on projections of available FY 2015 revenues. |
|------------------------------|---|

| | |
|-------------------------|--|
| (October-December 2013) | The consensus revenue number is announced. The Executive and Legislative Branches jointly agree and commit to a single tax revenue projection for the next fiscal year. Both the Governor's budget and the Legislature's budget are based off this number. |
|-------------------------|--|

A&F, under the direction of the Governor's Office, prepares the Governor's budget recommendations. Secretariat held hearings across the state to solicit input from the general public on programs and services under their jurisdiction. This input was considered by agencies and A&F in the development of their spending plans.

| | |
|--------------------------|--|
| Governor's Budget | The formal budget begins as a bill that the Governor submits to the Legislature. According to the State Constitution, the Governor must propose a budget for the next fiscal year within three weeks after the Legislature convenes, which this year translates into the 4th Wednesday of January. |
|--------------------------|--|

| | |
|--------------------|--|
| (January 22, 2014) | In odd years, the Governor's budget is called House 1 (H.1), and in even years it is called House 2 (H.2). |
|--------------------|--|

Accordingly, the FY 2015 budget will be filed as H.2 on January 22, 2014. More detailed information regarding the specific budget development process for FY 2015 can be found later in the Budget Development section.

| | |
|--|--|
| House Budget (February-April 2014) | The House Ways and Means Committee reviews the Governor's budget and develops its own budget recommendations. Individual members of the House of Representatives submit budget amendments, which are then debated on the House floor. The bill is finalized after it is debated, amended and voted on by the full House. |
|--|--|

| | |
|---|--|
| Senate Budget (February-May 2014) | The Senate Ways and Means Committee reviews both the Governor's and the House's budgets and develops its own recommendation. Individual senators submit budget amendments, which are then debated on the Senate floor. The bill is finalized after it is debated, amended and voted on by the full Senate. |
| Conference Committee Budget (June 2014) | House and Senate leadership assign members to a "conference committee" to negotiate the differences between the House and Senate bills. The conference committee report can only be approved or rejected, so no additional amendments can be made. |
| Veto (June 2014) | Once approved by both chambers of the Legislature, the Governor has ten days to review it. The Governor may approve or veto the entire budget, or may veto or reduce particular line items or sections, but may not add anything. If the Governor does not act within ten days, the conference committee bill becomes law. |
| Overrides (June 2014) | The House and Senate may vote to override the Governor's vetoes. Overrides require a two-thirds roll-call vote in each chamber. |
| Final Budget (June - July 2014) | Once the Governor signs the bill with his recommended vetoes, it becomes the budget for the fiscal year. The final budget is also known as the General Appropriations Act (GAA) or "Chapter (# to be determined) of the Acts of 2014." |
| | The new fiscal year 2015 begins on July 1, 2014. |

Developing Supplemental Budgets

While the GAA is the primary budget law, it is customary for supplemental budgets to be passed within a fiscal year, typically where unanticipated funding needs are identified for critical items or additional budget legislation is required to implement a funding requirement. A supplemental budget authorizes additional spending above GAA levels. A supplemental budget is similar to the GAA but is generally smaller in size and often contains technical or "corrective" language in addition to increasing funding. It addresses unforeseen growth, decline in state revenues, additional expenses or savings. The supplemental budget process is the same as the GAA budget process; supplemental budgets are bills that are filed by the Governor with the Clerk of the House of Representatives, debated and passed by both the House and Senate, negotiated in a Conference Committee and signed by the Governor in order to become law.

The timeline for supplemental budget legislation is usually shorter since supplemental budgets often provide funding for unforeseen situations that need timely resolution. For example, supplemental budget funding may be necessary from year to year to ensure that the Commonwealth can pay for unanticipated additional costs for snow and ice removal. When the GAA becomes law, specific assumptions for the winter's costs for snow and ice removal are in place. As the winter progresses and the Department of Transportation has to manage snow and ice removal, total projected costs may change and additional funding may be necessary.

Spending Plan and Budget Proposal Development

Spending Plan and Budget Proposal Development

The Executive Office for Administration and Finance (A&F) is the state agency responsible for preparing the Governor's budget recommendations and for oversight of the annual budget enacted by the Legislature, known commonly as the General Appropriations Act, or the GAA. Under state law, every state agency is required to annually prepare a budget for review and evaluation by A&F. The spending plan typically includes staff, expenditure and revenue estimates for the current fiscal year (FY 2014) as well as the agency's anticipated staffing additions or deletions, expenses and receipts for the next fiscal year (FY 2015) based on the assumption that they will maintain the same level of services and programs from one year to the next.

In July of each year, after the GAA is signed into law by the Governor, agencies present spending plans to A&F to identify in extensive detail how they will spend the funds appropriated for the current fiscal year. Agencies also reflect any changes that may be necessary to their operating budgets, whether savings or increased costs, as a result of projects and investments in the five-year capital plan.

Spending plans for FY 2014 were approved in September 2013 after A&F budget analysts carefully reviewed all spending and revenue projections. These approved plans then served as the base for developing the FY 2015 budget.

FY 2015 Budget Development

In developing budget recommendations for FY 2015, agencies incorporated projected costs for the programs and services they operate, such as anticipated changes in staffing, caseload growth or increases in fixed costs such as fuel and energy costs. Agencies also took into account changes in laws, regulations and policies that impact their programs and services for the next year. Based on A&F's projections for revenue and available budgetary resources, agencies were asked to focus on developing spending plans for FY 2015 with an emphasis on controlling or preventing spending growth over projected FY 2014 levels.

Legislative changes of note for FY 2015 include:

- **Affordable Care Act (ACA):** For the FY 2014 budget, agencies projected how the January 1, 2014 implementation of the federal ACA law would impact their spending and revenue in the second half of the fiscal year. In FY 2015, agencies projected full-year impacts.
- **Raise the Age:** In the fall of 2013, the Governor signed legislation that remands youthful offenders under age 18 to custody of the Department of Youth Services (DYS) rather than the Department of Corrections (DOC).
- **Family Child Care Collective Bargaining:** FY 2015 represents the first full year of costs from the unionization of the family child care system at the Department of Early Education (EEC).
- **Transportation Reform:** The FY 2014 budget and accompanying legislation passed in 2013 meaningfully reformed the state's transportation finance structure and called for investments in FY 2014 and the years beyond to stabilize MBTA finances, fund critical projects and redirect payroll costs from the capital budget to the operating budget. FY 2015 represents the second year of this reform, requiring additional investment to pay for key priorities contained within the legislation.

These plans were submitted to A&F and served as the base for the Governor's FY 2015 budget recommendations. After reviewing reported agency costs for FY 2015 and consulting its long-term financial model of sustainable growth levels, A&F established spending parameters that were

necessary to balance the state's budget. Following the submission of spending targets, A&F worked with each secretariat to assess the impact of reductions and identify which cuts would be most challenging for agencies to implement. A&F sought to mitigate these reductions to the greatest extent possible. A&F also sought proposals for reforms and additional cost-saving initiatives from state agencies; many of these initiatives are included in the Governor's FY 2015 budget.

The Administration, the Senate and the House held the annual Consensus Revenue hearing on December 11, 2013. The three branches received testimony from the Department of Revenue (DOR) and other economists regarding tax revenue expectations for FY 2014 and 2015. The expert testimony forecasted continued growth, albeit modest, in revenues and continued improvement in the Commonwealth's economic outlook.

Fiscal Year 2015 Post-Budget Release Process

In preparation for the start of FY 2015 on July 1, 2014, A&F will work with agencies to develop implementation plans well ahead of the beginning of the fiscal year. As part of the budget development process, most agencies successfully identified areas where reductions to programs and services may be necessary or where they may capitalize on efficiencies. The implementation planning process helps to ensure that all necessary steps are completed by the beginning of FY 2015 to ensure that agencies will be able to operate at expected funding levels.

Specific and General Financial Policies

Overview of State Finance

The state's finance laws are outlined in **Chapter 29** of the Massachusetts General Laws. (In August of 2012 the Governor signed legislation that constituted a significant re-write of Chapter 29 –Chapter 165 of the Acts of 2012- although most items related to the budget development process were left unchanged.) They require that the Governor file a balanced budget, that the House and Senate each produce a balanced budget and that the final general appropriation act (GAA) is in balance accordingly. Any supplemental budget bill that may accompany or follow a budget cannot impair the overall fiscal balance. Typically, surplus resources at the end of any given fiscal year will be deposited into the Commonwealth's Stabilization Fund, also known as the Rainy Day Fund. Any further use of the Fund's resources must be explicitly authorized in legislation.

Prior to the Governor's submission of the budget, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means are required to reach agreement on a "consensus tax revenue forecast" from which to build their spending projections. The consensus revenue process for FY 2015 is discussed in more detail later in this section. In addition to tax revenues, non-tax revenues are forecast within the Governor's budget and factor into the total amount of resources that are available to the state to support its costs in FY 2015.

Budget Administration

State finance law requires the Commonwealth to monitor revenues and expenditures during a fiscal year. As such, the Secretary of Administration and Finance is required to provide quarterly revenue estimates to the Governor and the Legislature and the Comptroller publishes a quarterly report of planned and actual revenues. Department heads are required to notify the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means of any anticipated decrease in estimated revenues for their departments from the federal government or other sources. Those same parties are also notified if a department projects that any appropriation will be insufficient to meet all expenditures required in the fiscal year by any law, rule, regulation or order not subject to administrative control.

If a revenue shortfall is identified, the Governor is required by section 9C of Chapter 29 to reduce agency appropriations or recommend a transfer from other funds.

In other years, if additional revenues are available, the Governor may recommend a supplemental budget. At the end of the fiscal year, the Comptroller determines the statutory balance of the budgeted funds and transfers any excess funds to the Stabilization Fund.

General Fiscal Policies of the Commonwealth

The following principles and policies were used to guide the development of the FY 2015 budget:

Financial Reporting

The Commonwealth possesses strong reporting capabilities, supported by accounting and payroll systems that are used consistently throughout state agencies and from which data is updated to an information warehouse.

- State agencies utilize the accounting and payroll systems to ensure adequate audit controls are in place for the purpose of reporting on the receipt and expenditure of tax dollars and other revenues.
- The presentation of the annual Statutory Basis Financial Report, Comprehensive Annual Financial Report and official bond statements will continue to adhere to full disclosure.
- Websites will continue to be published to present the annual budget in an interactive format.
- Since November 2011, the public has been able to visit the state's transparency website, "Open Checkbook", which is regularly updated with state payroll and expenditure data

Revenue

- In preparation of the annual budget, a consensus revenue estimate for taxes must be agreed to by the executive and legislative branches and will serve as the basis for building the budget.
- All revenue received by departments will be deposited with the Treasurer and recorded in the accounting system, ensuring the timely and transparent receipt of all state funding sources.

Cash Flow

- The Cash Management Division of the State Treasurer's Office utilizes close to a thousand operating accounts to track cash collections and disbursements for the Commonwealth. The Division relies primarily upon electronic receipt and disbursement systems. The State Treasurer, in conjunction with Comptroller and the Executive Office for Administration and Finance, monitors cash to maximize the Commonwealth's return on investment and minimize the use of borrowing.
- The State Treasurer, in conjunction with the Executive Office for Administration and Finance, is required to submit quarterly cash flow projections for the current fiscal year to the House and Senate Committees on Ways and Means on or before the last day of August, November, February and May. The projections must include estimated sources and uses of cash, together with the assumptions from which such estimates were derived and identification of any cash flow gaps. The State Treasurer's office, in conjunction with the Executive Office for Administration and Finance, is also required to develop quarterly and annual cash management plans to address any gap identified by the cash flow projections and variance reports. Legislation approved by the Governor on July 27, 2012 provides for monthly rather than quarterly distributions of local aid, beginning in fiscal 2014.
- The State Treasurer's office oversees the issuance of short-term debt to meet cash flow needs, including the issuance of commercial paper.

Expenditures

- The Comptroller is responsible for oversight of fiscal management functions, establishment of accounting policies and practices and publication of official financial reports.
- The Comptroller maintains the Massachusetts Management Accounting and Reporting System (MMARS), the centralized state accounting system that is used by all state agencies and departments, but not independent state authorities. MMARS provides a ledger-based system of revenue and expenditure accounts enabling the Comptroller to control obligations and expenditures effectively and to ensure that appropriations are not exceeded during the course of the fiscal year.
- MMARS also tracks receivables, payables, fixed assets and other process management.
- The Comptroller will annually review policies governing transactions in MMARS.

Expenditure Controls

- The amount of all obligations under purchase orders, contracts and other commitments for the expenditures of moneys are required to be recorded as encumbrances. Once encumbered, these amounts are not available to support additional spending commitments.
- As a result of these encumbrances, agencies can use MMARS to determine at any given time the amount of their appropriations available for future commitments.
- The bulk of state appropriations must be “subsidiarized” in the central accounting system with total funding budgeted and allocated for spending categories such as payroll, travel, operational expenses, leases and information technology services.
- Executive branch agencies are restricted from transferring funds between spending categories without first gaining the approval of the Executive Office for Administration and Finance.
- Total cash allotments, or the amount of total appropriations available for actual expenditure at any given time, are subject to a published schedule by the Secretary of Administration and Finance. A&F staff will consult state cash flow projections and agency expenditure activity before approving any increased allotments beyond the published schedule.

Internal Controls

- The Comptroller establishes internal control policies and procedures in accordance with state finance law. These policies require all departments to develop and maintain an internal control plan. Agencies are required to adhere to such policies and procedures.
- All unaccounted-for variances, losses, shortages or thefts of funds or property must be reported to the State Auditor, who is authorized to investigate and recommend corrective action.

Reserves

- The Commonwealth will aggressively seek to replenish the Commonwealth Stabilization Fund when able to do so.
- Capital gains tax revenues that exceed \$1.048 B will be deposited into the Fund to better calibrate spending with reliable revenue streams and to build a cushion against future economic and fiscal uncertainty. In fiscal year 2015 total capital gains receipts are projected to total \$1.170 B, an estimated \$122 M will be deposited in the Fund under this policy.
- The Governor’s FY 2015 budget refines the policy on settlements or judgments in excess of \$10 M to more closely align with the capital gains provision, which sets a threshold above which capital gains collections are unavailable to support budgetary expenditures and instead must be dedicated to the Commonwealth’s Stabilization Fund. While each of these judgments and settlements are one-time events there is a baseline amount of revenue that the Commonwealth collects from these on an annual basis and can responsibly budget against. This refinement would still preserve the primary goal behind the original provision: isolating volatile revenues and segregating them into reserves.

Debt Affordability

- The Commonwealth conducts an annual debt affordability analysis to determine the affordable level for the administrative bond cap (determining annual borrowing levels).
- Required funding for debt service and other debt-like instruments will not exceed 8% of budgeted revenues.

Capital Budget

- Bond-funded capital spending will be limited by an annual administrative bond cap that is established based on an annual debt affordability analysis. Annual growth in that cap will not exceed \$125 M each year and overall capital spending will not be more than 8% of budgeted revenues.

- A five-year capital investment plan will be developed and update annually, and will focus on affordability, targeted investments in projects that maintain our existing infrastructure and/or promote economic growth, and transparency.

Pensions

- The Commonwealth will continue to follow a pension funding schedule to address our unfunded liability and to pursue reforms that will reduce costs over the long term.
- In addition, 5% of any capital gains in excess of the statutory threshold (see above) will be used to fund the Commonwealth's unfunded pension liability.

Other Post-Employment Benefits

- To address the Commonwealth's retiree health care funding liability, reforms have been adopted that will annually allocate a portion (\$76 M in FY 2015) of the state's tobacco master settlement revenue to the State Retiree Benefits Trust Fund (SRBTF), the trust from which we pay for retirees' health costs. This portion of the tobacco settlement will increase incrementally each year until 2022, when it will be fully dedicated to SRBTF. In addition, included in Pension Reform legislation adopted in FY 2012, a new Commission was established to study and propose recommendations to further address the state's unfunded liability.
- In addition, 5% of any capital gains in excess of the statutory threshold (see above) will be used to fund the Commonwealth's OPEB liability.

Strategic Fiscal and Budgetary Policies

In developing the FY 2015 budget, special attention was paid in the following areas:

- Cost-containment in the state's various health care programs, including the costs for current and retired state employees and health coverage for low-income and unemployed residents in the Commonwealth.
- Preservation of programs to ensure residents can lead safe and healthy lives and find long-term employment in a competitive global economy:
 - Addressing youth and urban violence through investments in our youth and communities
 - Closing the achievement gap and protecting education funding as a cornerstone of long-term economic growth and opportunity.
 - Increasing job creation through investments that enhance Massachusetts' ability to compete for the jobs and businesses of tomorrow, such as green technology and the life sciences, while ensuring a more competitive environment for the state's private employers in more traditional sectors.
 - Ensuring the state's most vulnerable populations, particularly the disabled and those who have served our country, can continue to receive assistance and life-changing services from the state where needed.
- Adopt government reforms that promote efficiency and sustainability of services and ensure state dollars are stretched further.
 - Implementing technology improvements to support innovative service delivery to improve services for the public at lower costs to taxpayers.
 - Pursuing shared service models across state government more aggressively for the most-effective administration and operation of state agencies and programs.
 - Improving state purchasing and procurement processes to leverage state buying power and drive further cost savings.
- Identify additional recurring revenues to support worthwhile programs while recognizing the state cannot afford to maintain all programs and services that have been operated in the past.
- Reduce the use of temporary or one-time resources to balance the budget.

- Utilize long-term financial models to set annual and multi-year budget targets with respect to expected revenues, sustainable spending levels and appropriate annual use of non-recurring resources in developing a balanced budget.

Performance Management, Accountability and Transparency

- The FY 2012 budget established the Office of Commonwealth Performance, Accountability and Transparency (CPAT) to execute nation-leading strategies for improving performance and transparency, maximizing federal grants, reducing fraud, waste and abuse and informing our financial planning by using the latest economic and caseload forecasting tools.
- Since it was inaugurated in July 2011, CPAT has had some notable successes in driving reform and innovation across state government:
 - Performance Management - establishing a collaborative relationship with the Collins Center at UMASS Boston to develop strategies and dashboards for the Governor's four strategic priorities; initiating discussions with Secretariats to develop strategic plans and publish them by January 2013; and rolling out a comprehensive training program on performance management for staff across state government.
 - Enhanced Coordination and Federal Grants - leveraging experience in coordinating ARRA funds to secure and maximize federal dollars and ensure compliance with federal requirements; engaging Cabinet Secretaries to develop better cross-government coordination of grant applications and rewards; utilizing the outcome measurement regime required to comply with the federal Recovery Act for all grants secured in state government; and commencing procurement of unified grants management technology that will enable coordination to be achieved.
 - Transparency Website - launching the State's Open Checkbook website in December, which details state spending, including payrolls and pensions.
 - Program Integrity - making permanent the Lt. Governor's task force on fraud, waste and abuse, and coordinating efforts throughout government, including with other executive officers such as the Auditor and Attorney General.
 - Economic Forecasting & Analysis - appointing its Advisory Board and conducting its first meeting; developing its forecasting approach and methodology; began working with high impact service areas, such as MassHealth (Medicaid), to better model caseloads; and linking historical data into a 5-year economic model.
 - Program Budgeting – in the Governor's FY 2014 budget, the CPAT office championed a program-based budget, that clearly showed for all state funds (operating, federal, trust and capital) how state funds were being spent. This year's budget includes performance metrics, and in many cases corresponding data, alongside budget programs. Both of these accomplishments significantly enhance the transparency of the budget process in Massachusetts.

Overview of Budget Funds

Government Fund Types account for the general governmental activities of the Commonwealth and are organized as follows:

Budgeted Funds are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. Typically, the level of expenditures made annually from these fund sources is "subject to appropriation", meaning that no payments can be made from these funds until they are explicitly authorized in the state budget. The main budgeted funds include the General Fund the Commonwealth Stabilization Fund, the Massachusetts Tourism Fund, and the Commonwealth Transportation Fund, which are identified by the Comptroller as the operating funds of the Commonwealth.

Non-Budgeted Special Revenue Funds are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants, funds related to the tobacco settlement and the operations of the state lottery. Typically, these funds are available annually to one or more agencies for dedicated purposes, but do not require annual legislative approval for the use of the funding. Most funds are subject to annual reporting rules and all funds are subject to state accounting and audit practices.

Capital Projects Funds account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These resources are derived from proceeds of bonds and other obligations, which are generally received after related expenditures have been incurred, operating transfers authorized by the Legislature and federal reimbursements. Deficit balances in the Capital Projects Funds represent amounts to be financed.

Fiduciary Funds account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units and/or other funds.

Expendable Trust Funds account for trusts whose principal and investment income may be expended for a designated short-term purpose. They typically are created administratively for a brief period to allow a state agency to collect one-time revenue and spend this funding for a dedicated purpose. For example, the Department of Public Health receives funding from private organizations from time to time to conduct research and studies on specific issues and must collect and segregate funding dedicated for this purpose from all other funding sources.

Nonexpendable Trust Funds account for trusts whose principal cannot be spent.

Post Employment Benefit Trust Fund account for the net assets available for plan benefits held in trust for State Employees' and Teachers' Retirement Systems and Other Post Employment Benefits (OPEB) for retirees.

Agency Funds account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Individual Budgeted Funds

Statutory balance is defined as *a measure of the fiscal condition which includes current year budgeted revenues and expenditures plus any designated revenues from prior years, stabilization deposit and funds carried forward*. It also includes any use of stabilization or any other non-budgeted reserves. A more general discussion of the funds is below:

The *General Fund* is the Commonwealth's primary governmental fund. All governmental activities not specifically directed to another fund are accounted for in the General Fund. As a result, most budgeted expenditures of the Executive secretariats, the Legislature, Constitutional offices, Judiciary, institutions of higher education and independent commissions are paid for from the General Fund. It similarly receives a significant portion of sales, individual income and corporate taxes and the full amount of most other governmental taxes. It also receives federal reimbursement generated by the Commonwealth's Medicaid expenditures.

The *Commonwealth Transportation Fund* accounts for road and highway use revenues, including the gas tax, registry fees and the motor vehicles sales tax. The fund is used to pay debt service associated with highway maintenance and construction projects and provides funding for the operation of the independent Massachusetts Department of Transportation (MassDOT). Established as part of the

historic transportation reforms implemented in FY 2010, this fund replaced the former *Highway Fund* as the principal source of transportation related revenues and expenditures for the Commonwealth.

The *Massachusetts Tourism Fund*, authorized in section 35J of Chapter 10 of the General Laws, is funded with 35 % of the State's annual revenues received from the hotel occupancy tax authorized in section 3 of Chapter 64G. In FY 2015, Tourism Fund revenues are estimated to total \$53.3 M. The Fund's use is prescribed in Chapter 10, which includes a formula that assigns various funding levels for tourism promotion programs and activities including the Massachusetts Office of Travel and Tourism, regional tourism promotion agencies, the Massachusetts Office of International Trade and Investment, the Cultural Facilities Fund and the Massachusetts Convention Center Authority. While funding for the purposes prescribed in the section are being made in this budget, the specific requirements of the fund have been suspended through an outside section in the Governor's FY 2015 proposal.

The *Marine Recreational Fisheries Development Fund* accounts for all recreational saltwater fishing permit fees collected by the director of the division of marine fisheries. Fees collected in this fund shall be used for the development and administration of the recreational saltwater fishing permit program, to support science and conservation programs designed to improve recreational saltwater fishing and other recreational saltwater fishing improvement programs.

The *Commonwealth Stabilization Fund* is a reserve to enhance the Commonwealth's fiscal stability. A later section describes the Stabilization Fund in more detail.

Administrative Control Funds account for the revenues generated by certain administrative functions of government, for which the Legislature has required that separate funds be established. These funds include:

- *Temporary Holding Fund* –The fund accounts for cumulative tax revenues during the fiscal year in excess of permissible tax revenues as defined in Section 6A of Chapter 62F of the General Laws. The fund balance is transferred annually to the Stabilization Fund only to the extent that stabilization funds are used to fund expenditures of the Commonwealth. Overall, any remaining balance is transferred to the General Fund.
- *Intragovernmental Service Fund* – Accounts for the charges of any state agency for services provided by another state agency, for example, charges levied by the Human Resources Division for workers' compensation costs.

The *Inland Fisheries and Game Fund* accounts for revenues from license and permit fees for inland fishing, hunting, trapping and sporting licenses and revenue-producing stamps or the sales of land, rights and properties, gifts, interest and federal grant reimbursements. These revenues are used for developing, maintaining and operating the Division of Fisheries and Wildlife within the Department of Fish and Game. Annual spending from this fund is subject to annual appropriation by the Legislature, and any unexpended funds remain in the Fund for future use for related purposes.

The *Community College Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 17 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. This fund was created to collect one-time funds associated with initial licensing payments from gaming establishment operators. The FY 2014 budget budgeted against all projected licensing revenue; because one of the three projected licenses will likely not occur by the close of FY 2014, the budget assumes some revenue in FY 2015 from licensing as well. The revenue will be collected in this fund but used to support General Fund expenditures in FY 2015. In FY 2015, this fund is projected to collect \$19.1 M.

The *Manufacturing Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 13 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. This fund was created to collect one-time funds associated with initial licensing payments from gaming establishment operators. The FY 2014 budget budgeted against all projected licensing revenue; because one of the three projected licenses will likely not occur by the close of FY 2014, the budget assumes some revenue in FY 2015 from licensing as well. The revenue will be collected in this fund but used to support General Fund expenditures in FY 2015. In FY 2015, this fund is projected to collect \$14.6 M.

The *Local Aid Stabilization Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 5 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. This fund was created to collect one-time funds associated with initial licensing payments from gaming establishment operators. The FY 2014 budget budgeted against all projected licensing revenue; because one of the three projected licenses will likely not occur by the close of FY 2014, the budget assumes some revenue in FY 2015 from licensing as well. The revenue will be collected in this fund but used to support General Fund expenditures in FY 2015. In FY 2015, this fund is projected to collect \$5.63 M.

The *Local Capital Projects Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 11 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. This fund was created to collect one-time funds associated with initial licensing payments from gaming establishment operators. The FY 2014 budget budgeted against all projected licensing revenue; because one of the three projected licenses will likely not occur by the close of FY 2014, the budget assumes some revenue in FY 2015 from licensing as well. The revenue will be collected in this fund but used to support General Fund expenditures in FY 2015. In FY 2015, this fund is projected to collect \$12.38 M.

The *Gaming Local Aid Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect operating tax revenue by the Category 2 licensees. In FY 2015, this fund is projected to collect \$20 M.

The *Commonwealth Health and Prevention Fund*, established in this year's budget collects revenues generated from the elimination of the existing sales tax exemptions on the purchase of soda and candy. Monies appropriated from this fund will support programs and services administered by the Department of Public Health that augment the health and well-being of the citizens of the commonwealth, specifically programs related to addiction services, children and family health and health promotion.

The *Health Insurance Expansion Fund*, established in this year's budget, collects additional Medicaid funding provided by the federal government pursuant to the increased federal Medicaid assistance percentage under Section 2001 of the Patient Protection and Affordable Care Act of 2010 and Section 1201 of the Health Care and Education Reconciliation Act of 2010. Annual spending from this fund supports, subject to appropriation, the financing of health insurance coverage for low-income residents of the commonwealth.

Long-Term Forecasting

The Patrick Administration is the first Administration in Massachusetts to establish a long-term planning policy to ensure that the state budget is consistent with the principle of fiscal sustainability. According to the Commonwealth's Long-Term Fiscal Policy Framework, which is posted on www.mass.gov/anf, structural balance is achieved when budgetary spending is based on sustainable levels of revenue, excluding fluctuations that can occur as a result of the economic cycle. When the economy is operating under capacity, the policy benchmark to evaluate structural balance compares the cyclical shortfall in tax revenue to the use of one-time resources included in the budget to offset this shortfall. When the economy is operating over capacity, the policy benchmark compares the cyclical surplus in tax revenue to the deposit of excess resources into the stabilization fund.

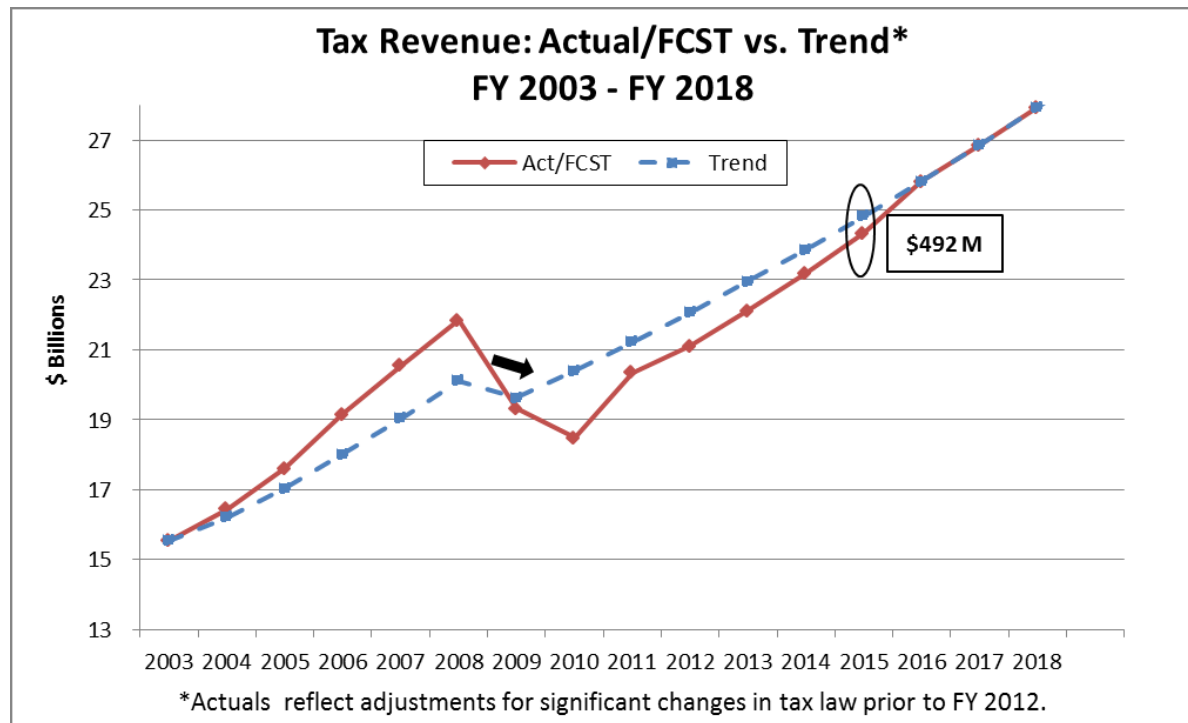
The Governor's proposed FY 2015 budget is in structural balance because the proposed \$225 M in net use of one-time resources is significantly lower than the estimated \$492 M cyclical shortfall. The \$225 M in net use of one-time resources is based on the \$334 M figure identified in the budget development write-up, less \$110 M in projected stabilization fund deposits. The estimated \$492 M cyclical shortfall is based on the long-term revenue forecast that was developed in concert with the consensus tax revenue process as described below.

Measuring Structural Balance

The policy benchmark for structural balance is based on a framework for long-term tax revenue forecasting that was developed by the Executive Office for Administration and Finance (A&F) and the state's Office of Tax Policy Analysis and uses revenue projections provided by outside economists. The revenue forecast is also used to evaluate other policy benchmarks identified in the Long-Term Fiscal Policy Framework.

The FY 2015 budget achieves structural balance based on an estimated \$492 M cyclical shortfall and the use of \$225 M in one-time resources, net of deposits into the stabilization fund. The cyclical shortfall represents the difference between the FY 2015 consensus tax revenue estimate of \$24.337 B and A&F's estimate of \$24.829 B in tax revenue that the Commonwealth would generate if the economy were at full capacity or "on trend." The difference between actual/forecasted tax revenue and trend tax revenue is depicted in Figure 1. The development of these estimates is described in more detail in the "Long-Term Revenue Forecast Methodology" section that follows.

Figure 1.



The use of \$492 M in one-time resources provides a significant margin of safety in comparison to the cyclical shortfall. Further, the Governor's proposed budget will maintain a balance of \$1.201 B in the stabilization fund at the end of FY 2015. The Commonwealth's appropriated stabilization fund balance for FY 2014 was the fourth highest in the country. The projected stabilization fund balance for year-end FY 2015 will ensure that there are sufficient resources to support the balance of the economic recovery and to provide protection in the event of another economic slowdown. For further discussion of the Stabilization Fund balance, see the Budget Challenges section.

Long-Term Revenue Forecast Methodology

The long-term tax revenue forecast used to estimate the cyclical shortfall is developed in three steps. First, a group of outside economists develop 10-year tax revenue forecasts for the FY 2014-FY 2023 time period. Second, these forecasts include an estimate of the long-run "steady-state" tax revenue growth rate, which reflects the level of tax revenue growth that may be expected in the future when the economy is at full capacity. Third, A&F develops an imputed revenue trend-line for each forecast, which is based on the FY 2023 tax revenue estimate, discounted by the steady-state tax revenue growth rate.

A summary of the external forecasts, A&F's estimates for long-term tax revenue growth, key assumptions, and calculations are included in Table 1 below. These results show strong revenue growth averaging 5.5% annually during a projected economic recovery between FY 2014 and FY 2016, a steady state growth estimate of 4.0% applied to the period between FY 2017 and FY 2023, and a resulting average growth rate of 4.3% during the full forecast period. The cyclical shortfall reflects the difference between the FY 2015 consensus tax revenue estimate of \$24.337 B and \$24.829 B, which is the FY 2015 estimate associated with the revenue trend-line calculated using the formula described above and noted in Table 1.

Table 1.

| | | | | |
|--|---------------------------|----------|----------|-------------------------|
| Commonwealth of Massachusetts | | | | |
| Long-Term Tax Revenue Forecast Summary | | | | |
| FY 2014 - FY 2023 (\$ Ms) | | | | |
| Tax Revenue Assumptions | | | | |
| FY14 Revised Tax Revenue Estimate | \$23,200 | | | |
| FY15 Consensus Revenue Estimate | \$24,337 | | | |
| | External Forecasts | | | A&F Estimate |
| | ACM | MTF | BHI | |
| Key Data Points | | | | |
| FY16 Tax Revenue Forecast | \$25,247 | \$25,337 | \$25,890 | \$25,822 |
| FY23 Tax Revenue Forecast | \$33,188 | \$31,655 | \$36,369 | \$33,980 |
| Compounded Annual Growth Rates (CAGR) | | | | |
| | (1) | | | |
| FY14-FY16 (Recovery) | 4.3% | 4.5% | 5.6% | 5.5% |
| Long-Run Steady-State | 4.0% | 2.6% | 4.4% | 4.0% |
| FY14-FY23 | 4.1% | 3.5% | 5.1% | 4.3% |
| Calculation of Estimated Cyclical Shortfall | | | | |
| A) FY15 Trend | (2) | \$24,187 | \$25,692 | \$25,766 |
| B) FY15 Tax Revenue Estimate | | \$24,337 | \$24,337 | \$24,337 |
| C) FY15 Estimated Cyclical Shortfall (A-B) | | \$150 | -\$1,355 | -\$1,429 |
| MEMO: FY 2014 Cyclical Shortfall | | | | -\$674 |
| (1) Includes assumed inflation for FY15-FY22 of 2.0%. | | | | |
| (2) FY15 Trend Tax Revenue = (FY23 Tax Revenue Forecast)/(1+4.0%) ⁸ . | | | | |

Role in the Long-Term Fiscal Policy Framework

The long-term tax revenue forecast also plays a central role in developing other policy benchmarks that are included in the Commonwealth's Long-Term Fiscal Policy Framework. The projections for long-term growth in tax revenue and the Massachusetts economy are used to formulate policy benchmarks for the sustainable rate of growth in total spending and health care spending in the budget.

M.G.L. Chapter 224, the Health Care Cost Containment law, requires the Secretary of A&F and the House and Senate Ways & Means Committees to develop an estimate of long-term growth in Massachusetts potential gross state product, to be used by the Health Policy Commission to set the state's health care cost growth benchmark. Potential gross state product, a measure of the output of the Commonwealth's economy excluding fluctuations due to the business cycle, is also an estimate of the long-term trend in gross state product.

The alignment of these policy benchmarks and the best practices for long-term planning prescribed by GFOA and GASB are described in more detail in the Commonwealth's Long-Term Fiscal Policy Framework. The most recent version of the Long-Term Policy Framework was published in January 2014, based on the FY 2014 budget proposal, and is posted on www.mass.gov/anf.

Long-Term Planning and Annual Budget Development

Beginning in FY 2012, the A&F budget staff has consulted the Long-Term Fiscal Policy Framework cited above to establish parameters for agency and program cost growth based on projected annual revenues over medium- and long-term periods. These parameters were used to inform decision-making related to allowable hiring and related program expenditures and served to help A&F develop funding targets for FY 2015 to ensure that state spending ultimately could be sustained by available resources.

FY 2014 Update

In July 2013, the Governor signed into law the FY 2014 General Appropriations Act (GAA) – Chapter 38 of the Acts of 2013. The FY 2014 budget authorized spending of \$34.064 B (or \$35.694 B when including the \$1.630 B annual pension contribution), a 0.5% increase (or 5.3% with the pension contribution) from FY 2013 actual expenditures of \$33.894 B.

FY 2013 Year-End Supplemental Funding for FY 2014

Similar to most fiscal years, total FY 2014 spending was increased upon the adoption of “year-end” FY 2013 supplemental budget legislation, which (along with previous authorizations) authorized \$166.7 M in FY 2013 budgetary appropriations (known as Prior Appropriations Continued or PACs) to continue to be expended into FY 2014. The year-end FY 2013 supplemental bill (Chapter 118 of the Acts of 2013) also provided additional supplemental appropriations for FY 2014 in the amount of \$220.3 M. Of the \$220.3 M in supplementary appropriations, \$174 M adjusted the transfer schedule to an off-budget trust fund, the Medical Assistance Trust Fund, to align federal payment authorization with the fiscal year. This change was the result of a timing challenge rather than an increased obligation. In sum, these changes bring total FY 2014 spending up to \$34.450 B.

FY 2014 Original One-Time Resources

When the Governor signed the FY 2014 budget into law, the Executive Office for Administration and Finance (A&F) projected a total of \$696 M in non-recurring or “one-time” resources needed to maintain a balanced budget this year.

| FY 2014 One-Time Resources | |
|---|------------|
| \$s in millions | |
| Budgetary Resources: | |
| Stabilization Resources: | 350 |
| Stabilization Fund Interest: | 11 |
| Delay FAS 109 Deduction: | 46 |
| Adjust DSTI Hospital Payments Fund: | 41 |
| One-Time Gaming Funds Supporting Ongoing Costs: | 32 |
| Sale of Assets: | 42 |
| Procurement Savings: | 30 |
| OPEB funded through Debt Service Reversions: | 51 |
| Tax Settlements to General Fund: | 35 |
| Non-Budgetary Resources: | |
| Group Insurance Trust Funds: | 40 |
| Quasi Public Contributions: | 10 |
| Commonwealth Care Reserves: | 9 |
| TOTAL ONE TIME RESOURCES | 696 |

The largest one-time resource was \$350 M of Stabilization Fund (also known as rainy day fund) resources. Other one-time resources include \$46 M in delaying the FAS 109 tax deduction and \$59 M in utilizing non-budgetary resources, largely in health care related trust funds and from shifting costs to quasi-public authorities for programs in line with their missions.

FY 2014 January Revenue Revision

On January 14, 2014, based on available data on tax revenue collections and economic trends, the Secretary for Administration and Finance revised the tax revenue forecast for FY 2014 to \$23.200 B. This represents an increase of \$403 M from the \$22.797 B tax revenue estimate assumed in the FY 2014 General Appropriations Act (GAA). The revised tax revenue estimate for FY 2014 is within the range of estimates provided by economists and other experts at the consensus revenue hearing in December 2013, and accounts for \$281 M in above benchmark year-to-date tax revenue collections, revised economic projections for the remainder of the year and tax law changes including the recent income tax rate reduction.

As a result of A&F's ongoing fiscal management, A&F updated its projected one-time resources needed to balance the FY 2014 budget to a total of \$667 M. A&F estimates that \$31 M of FY 2013 PACs carried into FY 2014 are used to support ongoing costs.

| Revised FY 2014 One-Time Resources | |
|--|------------|
| \$s in millions | |
| Budgetary Resources: | |
| FY13 Resources Used to Support Ongoing FY14 Costs: | 31 |
| Stabilization Fund Withdrawal: | 350 |
| Stabilization Fund Interest: | 6 |
| Delay FAS 109 Deduction: | 46 |
| Medicaid Payment Schedule Changes: | 41 |
| Gaming Licensing Funds Supporting Ongoing Costs: | 15 |
| Sale of Assets: | 30 |
| Procurement Savings: | 30 |
| OPEB funded through Debt Service Reversions: | 51 |
| Non-Budgetary Resources: | |
| Trust Fund Sweeps: | 61 |
| Quasi Public Contributions: | 7 |
| TOTAL ONE TIME RESOURCES | 667 |

Revised FY 2014 Estimated Spending

The table outlines the changes to FY 2014 spending since the Governor signed the GAA into law, including PACs, supplemental funding and net A&F contingencies (combination of surpluses and deficiencies recognized in A&F's budget assumptions). All FY 2014 estimated spending amounts used in this document and the Governor's FY 2015 budget recommendations reflect these assumptions.

| FY 2014 Estimated Spending \$s in millions | |
|--|---------------|
| FY 2013 Spending | 32,342 |
| FY 2014 GAA | 34,063 |
| <i>FY 2013 Prior Appropriations Continued (PACs) into FY 2014</i> | 167 |
| <i>Supplemental Budget - Chapter 118 of the Acts of 2013</i> | 220 |
| <i>Net ANF Contingency Expenditures</i> | 232 |
| FY 2014 Estimated Spending | 34,682 |
| FY 2014 GAA - % Change from FY 2013 Spending | 5.3% |
| FY 2014 Estimated Spending - % Change from FY 2013 Spending | 7.2% |

*excludes dedicated revenue for pensions

Fiscal Year 2015 Budget Development

Critical Factors for FY 2015 Budget Development

When developing the annual operating budget, there are three factors that must be considered:

- Loss of any one-time resources utilized in the preceding year's budget;
- Growth in costs to operate state programs and services; and
- Changes in available budgetary revenues, including tax collections and other non-tax sources.

Since the state budget must be balanced each year, the year-to-year impact of these factors – and how they affect available budgetary resources – plays a critical role in determining how challenging it will be to develop a balanced budget for any given year.

One-Time Resources

As noted in the preceding section, the FY 2015 state budget relies on an estimated \$334 M in one-time resources to remain in balance. This figure is \$224.6 M after accounting for capital gains in excess of the General Fund threshold into the Stabilization Fund. This amount is \$333 M below (\$384.6 M on a net basis) one-time resources used in FY 2014 and within the sustainable level of one-time resources as documented by A&F's long-term fiscal policy framework released in January 2014. The policy framework stresses the importance of limiting the reliance on one-time resources, particularly as the economy recovers. Given the limited availability and appropriateness of one-time resources, A&F developed the FY 2015 budget as to ensure that FY 2015 utilized significantly fewer one-time resources than the FY 2014 budget. A more detailed section follows on the state's Stabilization Fund (also referred to as the Rainy Day fund).

Cost Growth and Major Budget Increases

Since state tax revenues experienced an historic drop in FY 2009 (falling more than \$3 B in one year), the state has needed to control spending through reductions, reforms and other savings initiatives across almost every area of state government. This has been in the face of growth in program caseloads to historic highs among state-operated safety net programs, such as MassHealth (Medicaid), the Supplemental Nutrition Assistance Program (formerly known as Food Stamps) and family homelessness. Enrollment and utilization growth in safety net programs has required the state to shift resources away from other areas in order to preserve subsidized benefits for the populations most adversely impacted by the economic downturn.

In FY 2015, most state agencies reported modest levels of cost growth. However, there are several areas where more robust cost growth is likely, such as subsidized health care for low-income residents; employee and retiree health care; human services/safety net spending, including rates for human service providers through Chapter 257; K-12 aid to cities and towns (Chapter 70); debt service; and annual state pension contributions. Over the past several fiscal years, these cost drivers constitute the majority of year-on-year increases that have to be accounted for in developing the annual operating budget. Other areas in the state budget typically experience modest cost increases from year to year, mostly related to negotiated wage increases, leasing, the cost of fuel or other factors that are sensitive to annual cost inflation.

Annual Change in Budgetary Resources

The third critical factor in developing the FY 2015 budget is the amount of budgetary resources that are available to support operating expenses. As discussed in further detail below, tax revenues make up the largest component of state budgetary resources, representing 62% percent of the total estimated FY 2015 budgetary revenues. Tax revenues also typically represent the greatest contributor to new

state revenues in any given year. Other important resources include non-tax revenues such as federal reimbursements and departmental revenues. Historically, these revenues have increased consistently with related programmatic expenditures. Similarly, other budgetary transfers from non-budgeted sources have been relatively flat from year-to-year.

FY 2015 Tax Revenues

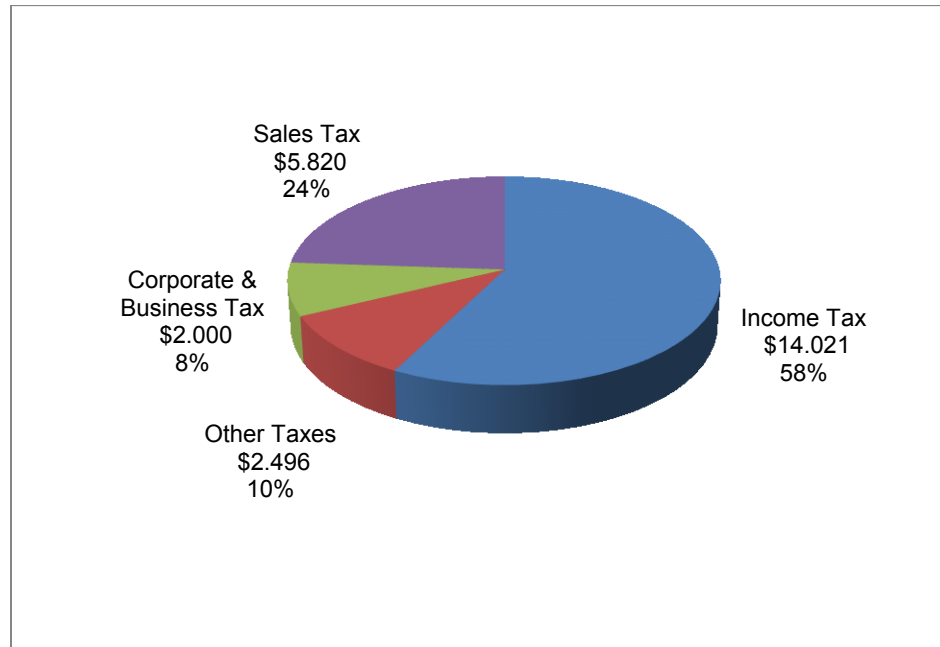
As discussed in greater detail below, FY 2015 tax revenues are projected to increase over FY 2014 levels, as tax revenue forecasters expect continued improvement in Massachusetts's economic outlook. Tax revenues, however, are still substantially below what they would have been in FY 2015 without the economic recession. The FY 2015 consensus tax projection totals \$24.337 B.

| FY 2015 Tax Consensus Figures (\$s in millions) | |
|---|--------------|
| Original FY14 GAA Estimate*: | 22,797 |
| Revised FY14 Projection (Jan. 14, 2014): | 23,200 |
| FY14 Revised vs. Original: | 403 |
| FY15 Consensus Figure: | 24,337 |
| FY15 Consensus vs. FY14 Revised Estimate | 1,137 |
| <i>* Here includes \$46 M for one-time tax increase associated with the delay of FAS 109 corporate tax deduction.</i> | |

FY 2015 Consensus Revenue Forecast

Each year, the Administration, the House of Representatives and the Senate consult with economists and other groups to gather information and analysis on the condition of the U.S. and Massachusetts economies. They use that information to project state tax revenue for use in the state budget. The following is a general description of the consensus revenue process.

FY 2015 Consensus Tax Revenue Estimate of \$24.337
(in \$ Billions)



General Information Regarding Consensus Revenue

The consensus revenue process is required under M.G.L. c.29, s.5B, which states that on or before January 15th, the Secretary of Administration and Finance (A&F) shall meet with the House and Senate Committees on Ways and Means to jointly develop a consensus tax revenue forecast for the next fiscal year's budget. The law requires that the consensus revenue estimate be placed before the General Court in the form of a joint House and Senate Resolution for full consideration.

On December 11, 2013, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means held a public hearing in Boston and heard testimony from the Massachusetts Department of Revenue (DOR), the Massachusetts Taxpayers Foundation, Beacon Hill Institute and economists from the University of Massachusetts and Northeastern University. The three branches subsequently agreed upon a FY 2015 tax revenue estimate of \$24.337 B, consistent with testimony presented at the hearing. This estimate also assumes that the state will collect \$1.17 B in capital gains-related revenues in FY 2015, \$122 M of which will be deposited into the Stabilization Fund under the state law that caps the amount of this volatile revenue source that can be included in the operating budget.

As part of the consensus revenue process, the Secretary, House and Senate also agree on the amount of tax revenues that will need to be transferred to support the State's Retiree Pension Fund, the School Building Authority, the Massachusetts Bay Transportation Authority (MBTA) and the Workforce Training Trust Fund pursuant to statutory requirements. For FY 2015, these transfers are estimated to total \$3.398 B and will be directed as follows:

- School Modernization and Reconstruction Trust Fund = \$771.5 M;
- MBTA State and Local Contribution Fund = \$811.3 M;
- Pension Reserves Investment Trust Fund = \$1.793 B; and
- Workforce Training Trust Fund = \$22.2 M.

Basis for the FY 2015 Consensus Revenue Forecast

FY 2014 tax revenues are estimated to be \$23.2 B, representing an actual increase of 4.9% and a baseline increase of 4.0% from FY 2013 collections. The baseline calculation adjusts for the impact of tax law and processing changes, so it is a better indicator of underlying economic activity. Through December 2013, FY 2014 year-to-date tax revenues were up 7.1% actual and 6.5% baseline, which was \$282 M above the year-to-date benchmark based on the FY 2014 General Appropriation Act (GAA) estimate of \$22.797 B (including the impacts of the revenue initiatives in the FY 2014 budget and the Sales Tax Holiday in August 2013). It is expected that as the economy continues to recover, tax collections for the remainder of FY 2014 will increase by \$363.6 M (3.0%) actual and \$236.4 M (2.0%) baseline from the same period in FY 2013.

The FY 2015 consensus tax revenue estimate is \$24.337 B, representing revenue growth of 4.9% actual and 5.0% baseline from the FY 2014 estimate of \$23.2 B. The FY 2015 estimate assumes that the national and state economies will grow moderately in FY 2014 and growth will accelerate in FY 2015. In developing the consensus estimate, the Commonwealth relies on economic forecasts from Moody's Economy.com, Global Insight and the New England Economic Partnership (NEEP). The economic forecasts upon which the consensus revenue estimate is based are as follows:

- The growth of the national economy is expected to be moderate in FY 2014 but accelerate in FY 2015. Uncertainties related to the faltering recovery from the Eurozone's recession and U.S. fiscal policies continue to be sources of risk to economic growth. Real Gross Domestic Product (GDP) growth for the full FY 2014 is projected to be 2.1% to 2.2% compared to growth of 2.0% in FY 2013 and 2.4% in FY 2012. In FY 2015, real GDP growth is projected to range from 2.8% to 3.9%;

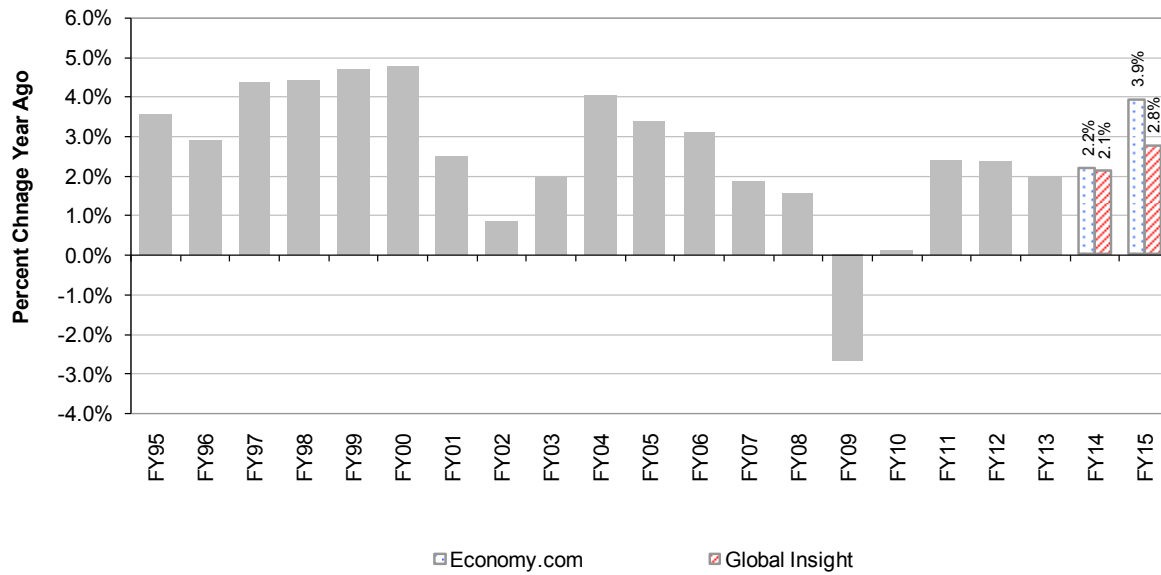
- Massachusetts employment is expected to increase by 0.9% to 1.3% over the remainder of FY 2014, and by 1.1% to 1.4% for FY 2014 as a whole. For FY 2015, Massachusetts employment is expected to grow by 1.3% to 1.5%;
- Massachusetts personal income (excluding capital gains) is expected to grow by 3.5% to 4.6% over the remainder of FY 2014 and 3.5% to 4.5% for FY 2014 as a whole. For FY 2015, Massachusetts personal income is projected to grow by 4.8% to 7.0%;
- Massachusetts wages and salaries are projected to increase by 3.2% to 4.6% for the remainder of fiscal year 2014 and 3.3% to 4.7% for the year as a whole. For FY 2015, the growth in Massachusetts wages and salaries is projected to range from 4.7% to 7.6%;
- Massachusetts retail sales growth is expected to range from 2.5% to 4.8% over the remainder of FY 2014 and 2.8% to 4.7% for the fiscal year as a whole. For FY 2015, Massachusetts retail sales are projected to grow by 3.6% to 6.1%;
- Corporate profits at the national level are expected to increase by 1.6% to 8.9% over the remainder of FY 2014, and by -1.6% to 8.0% for the fiscal year as whole. There are no forecasts for state corporate profits. For FY 2015, growth in corporate profits is projected to range from 5.9% to 8.5%;

In addition to the economic forecasts described above, the consensus revenue estimate takes into account forecasts for capital gains realizations and taxes. The consensus agreement capital gains forecast is based on the following considerations:

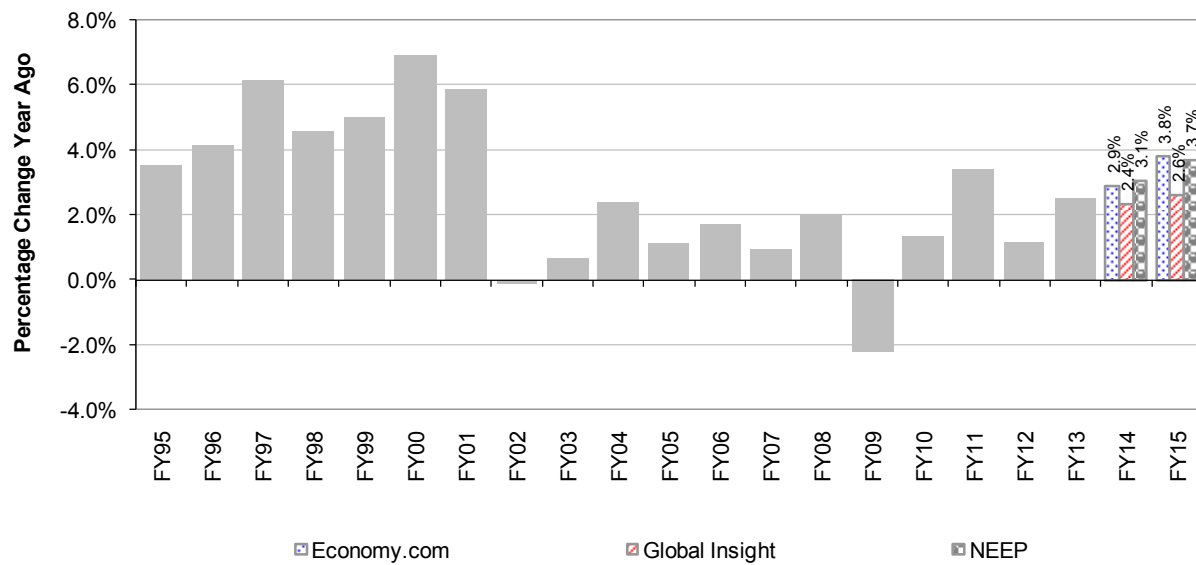
- Preliminary tax year 2012 data indicates that Massachusetts capital gains realizations increased by approximately 42.8% in tax year 2012 to \$25.0 B. FY 2013 taxes on those capital gains realizations totaled approximately \$1.407 B, an increase of approximately \$413 M, or 41.5%, from FY 2012 (taxes on tax year 2012 capital gains realizations were paid mostly in FY 2013);
- The stock market, as measured by the average of the S&P 500 over the entire year, rose by 19.1% in calendar year 2013 (which largely determines FY 2014 capital gains taxes), and is expected to increase by 3.8% to 8.4% in calendar year 2014 (which largely determines FY 2015 capital gains taxes). Massachusetts capital gains realizations are projected to decrease by 31% in calendar year 2013 but increase by 22% in calendar year 2014.

The charts below show the national and state economic forecasts presented at the December 11, 2013 consensus revenue hearing as well as the consensus estimate assumption for capital gains realizations and taxes, all of which were taken into consideration in developing the revised FY 2014 and FY 2015 consensus revenue estimates.

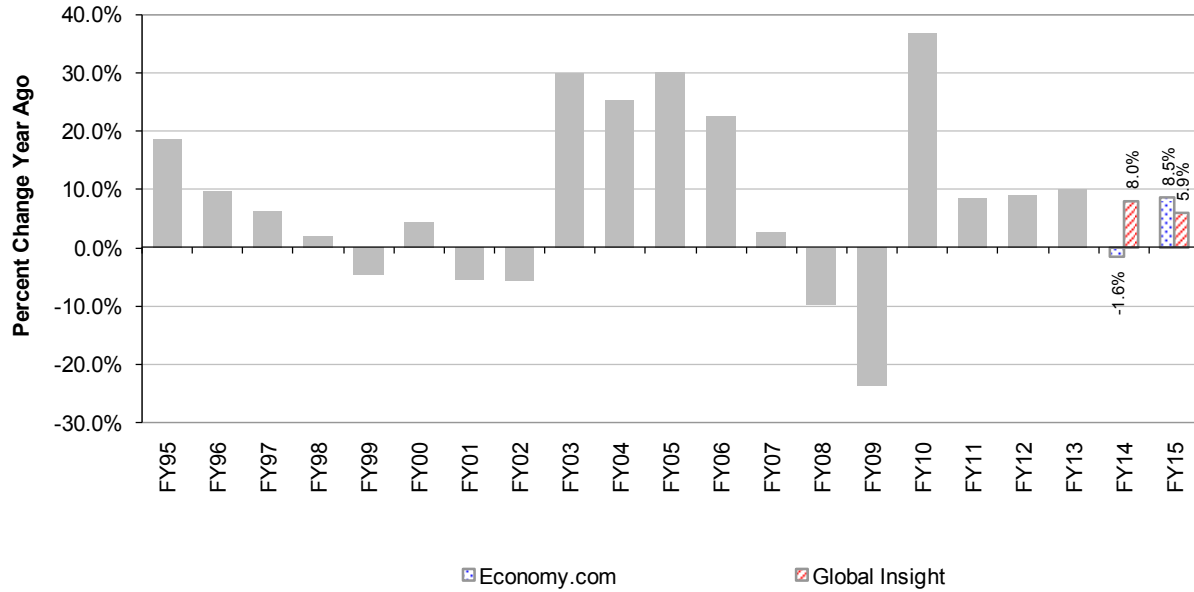
Real U.S. GDP Growth, FY1995-2015



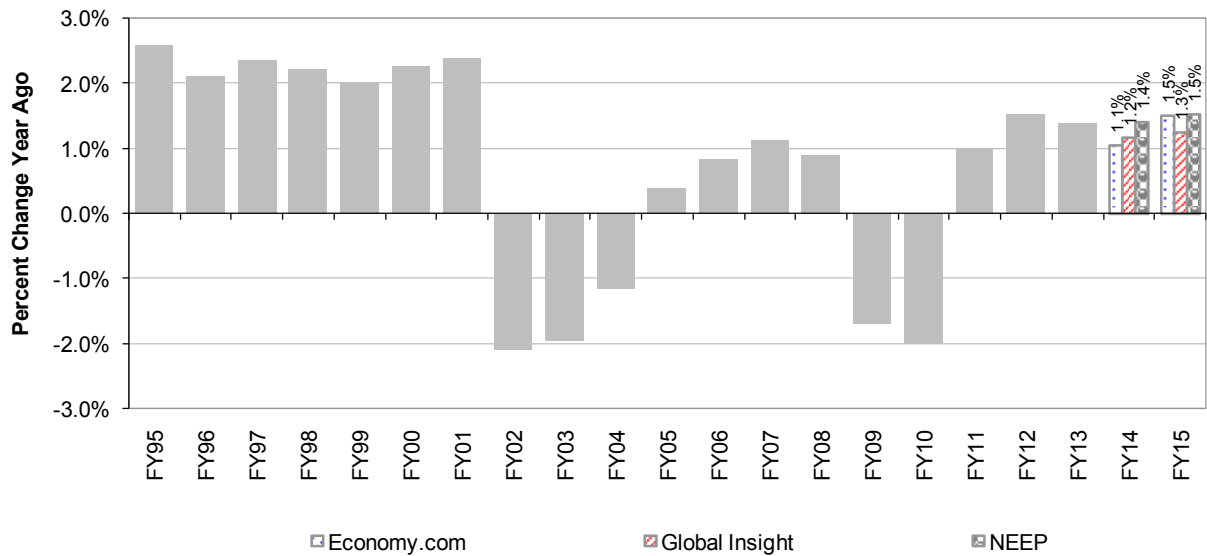
Massachusetts Real GDP Growth, FY1995-2015



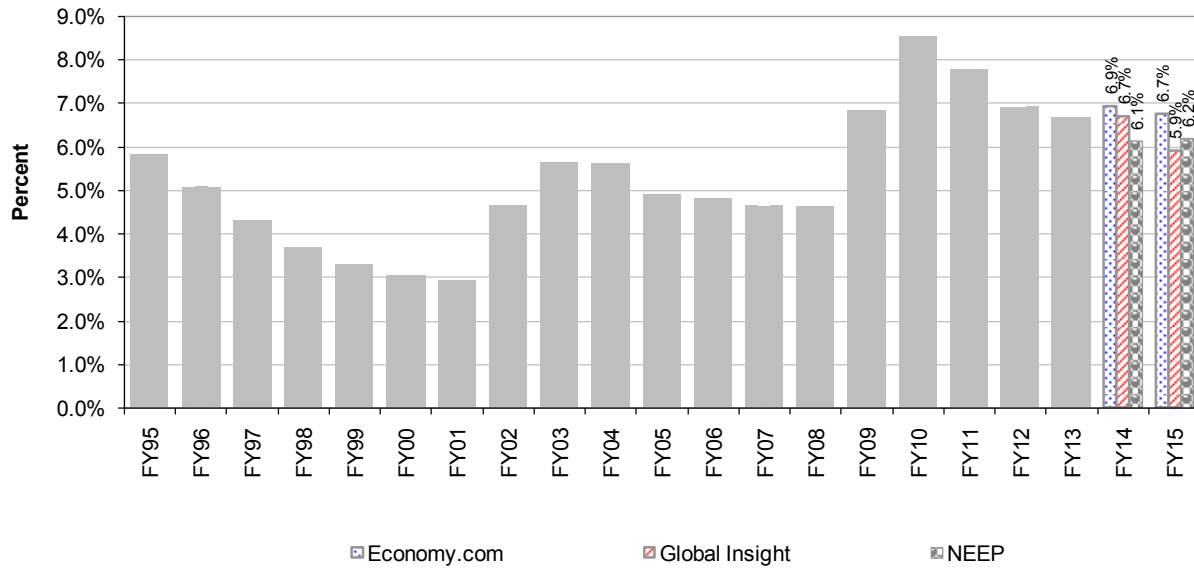
U.S. Corporate Profits Growth, FY1995-2015



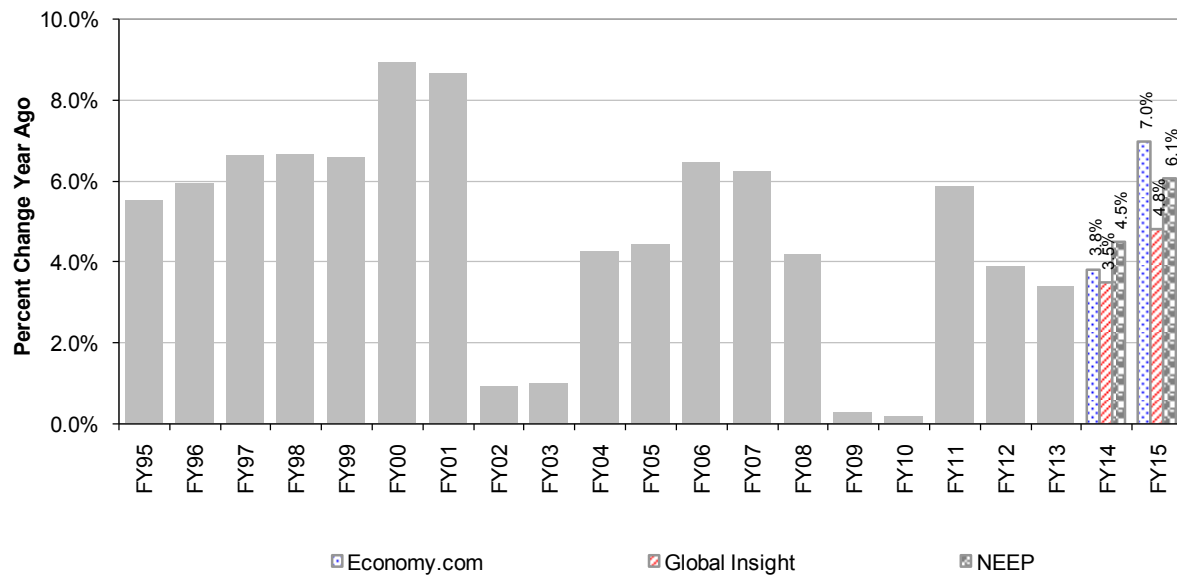
Massachusetts Employment Growth, FY1995-2015



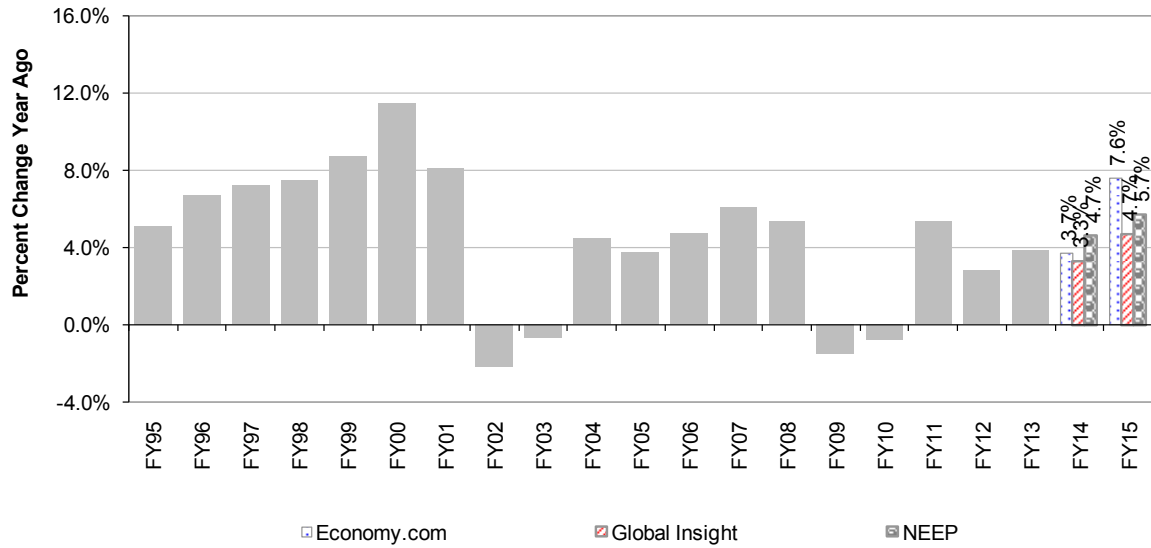
Massachusetts Unemployment Rate, FY1995-2015



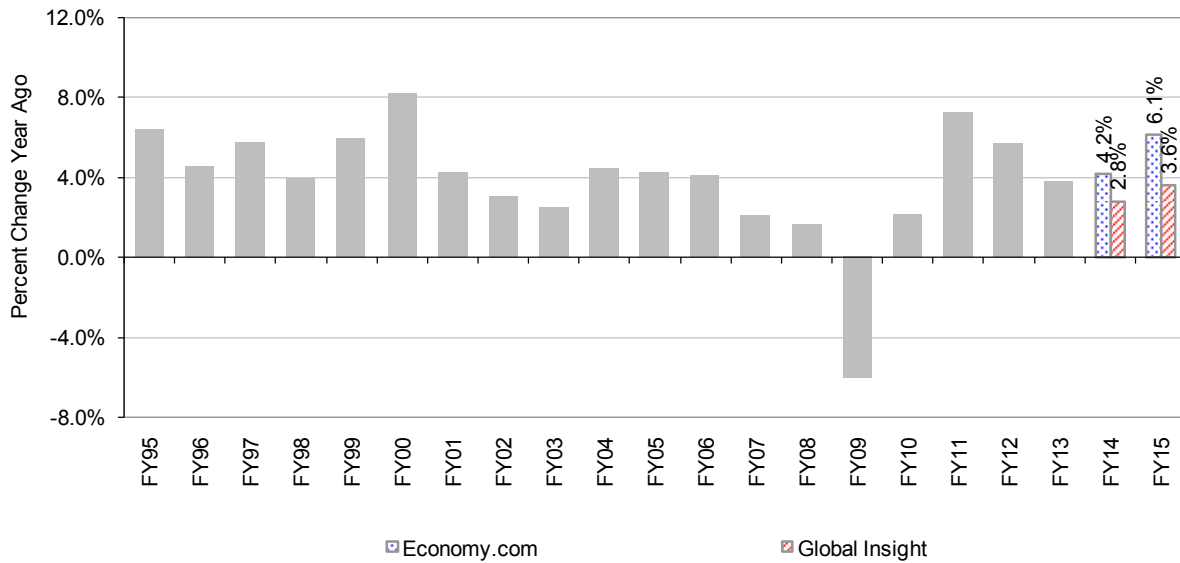
Massachusetts Personal Income Growth, FY1995-2015



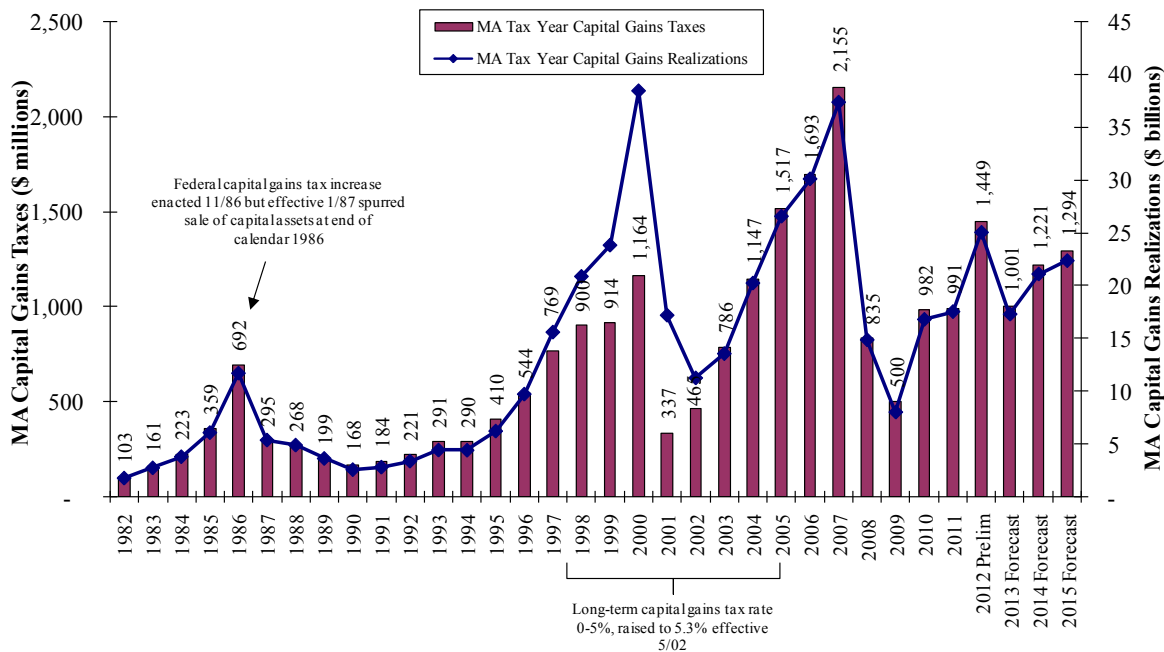
Massachusetts Wage and Salary Growth, FY1995-2015



Massachusetts Retail Sales Growth, FY1995-2015



Massachusetts Capital Gains Realizations and Taxes



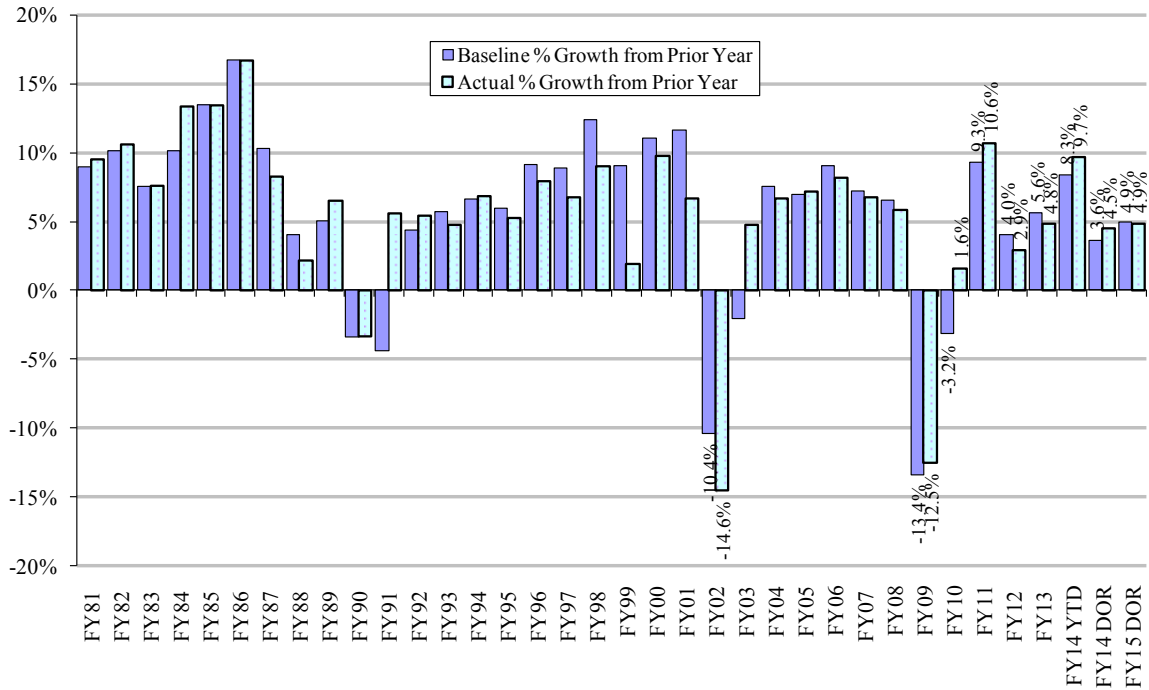
Based on these economic projections and actual tax collections through December 2013, FY 2015 tax collections are projected to grow by \$1.137 B, or 4.9% actual and 5.0% baseline from FY 2014 tax collections, with income tax collections growing by 5.0% actual and 5.4% baseline, sales tax growing by 5.8% actual and 4.9% baseline, and corporate/business taxes decreasing by 1.4% actual and 0.8% baseline, as shown in the chart below.

FY15 Consensus Tax Revenue Forecast

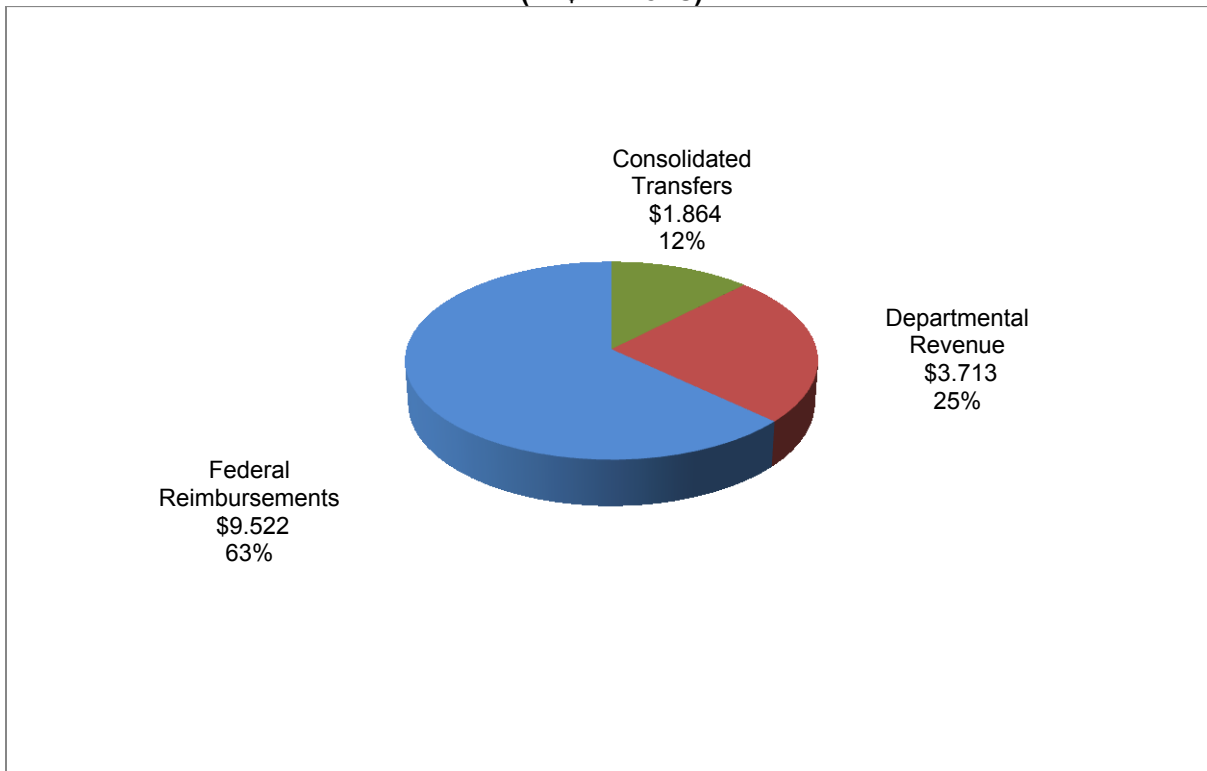
| Tax Type | % Actual Revenue Growth from FY14 | % Baseline Revenue Growth from FY14 | FY15 Revenue Estimate (\$ Millions) | FY15 Growth from FY14 (\$ Millions) |
|---------------------------|---|--|--|---|
| Total Income | 6.1% | 6.7% | 14,021 | 810 |
| Withholding | 5.0% | 5.4% | 10,929 | 516 |
| Sales | 5.8% | 4.9% | 5,820 | 319 |
| Corporate/Business | -1.4% | -0.8% | 2,384 | -33 |
| Other | 2.0% | 0.7% | 2,112 | 42 |
| Total | 4.9% | 5.0% | 24,337 | 1,137 |
| Memo: Capital Gains Taxes | 10.4% | 10.4% | 1,170 | 110 |

The chart below shows historical trends in actual and baseline tax revenue growth.

Actual and Baseline Tax Revenue Growth, FY1981-FY2015



House 2 Total Non-Tax Revenues: \$15,099 B
(in \$ Billions)



Federal Revenues

Federal revenues are collected through reimbursements for the federal share of entitlement programs such as Medicaid and through block grants for programs such as Temporary Assistance for Needy Families (TANF) and Child Support Enforcement. The amount of federal reimbursements to be received is determined by state expenditures and federal regulations that govern federal programs. A&F staff work with agencies to project spending levels for these federally-supported programs and the resulting federal reimbursements those expenditures will generate. Federal revenues are projected to increase by \$927 M next year, largely reflecting increased Medicaid expenditures, for which the federal government typically reimburses the state \$0.50 for every dollar expended. Due to the implementation of the federal Affordable Care Act (ACA), a significant amount of Medicaid spending will be reimbursed at higher rates ranging from 75% to 100%, providing \$350 M in additional federal revenue for MassHealth members that were in subsidized programs (MassHealth waiver programs, Commonwealth Care and Medical Security Program) prior to ACA implementation.

Departmental Revenues

Departmental revenues are derived from licenses, tuition, fees for programs and services, reimbursements and assessments for services including, but not limited to, revenues from the Registry of Motor Vehicles, reimbursement of health care costs from municipalities participating in the state's Group Insurance Commission (GIC) health care programs, drug rebate money received by the Executive Office of Health and Human Services, interest earnings received on the state's budgeted fund balances and fees collected by the Secretary of State's Office. To the extent possible, the Administration has minimized fee increases. However, M.G.L. c.7 s.3B provides for an annual review of fees to confirm that they are sufficient to defray the cost of providing the service. As part of this exercise, A&F analyzes historical non-tax revenue receipts and works with agencies to develop budget-year projections for these revenues. During the budget process, agencies review the fees to ensure they are current and reflect the actual cost of doing business. In FY 2015, total departmental revenues are projected to grow modestly by \$120.7 M before accounting for additional revenue proposals, largely due to increased economic activity and cyclical fee collections.

In addition to underlying growth, the Governor's budget includes \$24.2 M in increased departmental revenue generated by expanding a 5 cent bottle deposit to include non-carbonated beverage containers such as water, juice and tea. This initiative is both a revenue generator for the Commonwealth and a cost saver, as the increased incentive to recycle is anticipated to save municipalities up to \$7 M in solid waste management costs.

As mentioned above, the Governor's budget includes two sections that give a detailed overview of projected non-tax revenue for FY 2015. Section 1B details projected FY 2015 non-tax revenue receipts by the department, board, commission or institution that administers and collects the respective revenue source. The online version of the Governor's budget enables users to further examine each governmental area and view the title and description of each revenue source contributing to that area's total non-tax revenue. Additionally, the fund statements, which are included in the "Financial Statements" section of the budget document, offer another view of departmental revenues by operating fund.

Consolidated Transfers

Consolidated transfers reflect inflows to the General Fund from non-budgeted funds, which include annual tobacco settlement proceeds received as part of the Master Settlement Agreement with tobacco companies, net revenues from the State Lottery Fund, fringe revenue to recoup the cost of various statewide benefits assessed on non-budgeted funds and revenues from the Commonwealth's Unclaimed Property Division. A&F solicits agency feedback and uses historical data to project transfers to and from the budgeted funds for the proposed budget year. Section 1C of this document provides further detail. In FY 2015, consolidated transfers are projected to decline by \$274.5 M.

FY 2015 Budget Recommendation

FY 2015 Budget Recommendation

| Annual Change in Budgetary Resources | | | |
|--|----------------------|--------------------|------------------|
| | FY 2014 Estimated | FY 2015 House 2 | Annual Change |
| Budgetary Revenue: | | | |
| Projected Baseline Tax Collections* | 23,154.4 | 24,337.0 | 1,182.6 |
| Transfer of Capital Gains in Excess of Statutory Maximum | (37.0) | (122.0) | (85.0) |
| Transfer for Annual Pension Contribution | (1,630.0) | (1,793.0) | (163.0) |
| Transfer for OPEB Liabilities** | - | (75.0) | (75.0) |
| Transfers of Tax Revenue to MBTA, SBA and Workforce Training Fund | (1,549.8) | (1,605.0) | (55.2) |
| Federal Reimbursements | 8,595.0 | 9,522.0 | 927.0 |
| Departmental Revenues | 3,569.2 | 3,689.9 | 120.7 |
| Transfers from Non-Budgeted Sources | 1,844.0 | 1,744.5 | (99.5) |
| Stabilization Fund Withdrawal | 350.0 | 175.0 | (175.0) |
| Prior Year Funds Used to Support Current Year Budgetary Spending | 245.2 | 13.9 | (231.3) |
| Delay of FAS 109 | 45.6 | 45.6 | - |
| Other New Revenues Supporting the Budget: | | | |
| Aligning Settlements with Capital Gains Stabilization Fund Policy*** | - | 203.5 | 203.5 |
| Closing Tax Loopholes | - | 40.3 | 40.3 |
| Taxing Candy and Soda to Support Public Health Programs | - | 57.0 | 57.0 |
| Revenue from Category 2 Gaming Establishment Operation | - | 20.0 | 20.0 |
| Modernize Bottle Redemption | - | 24.1 | 24.1 |
| CHANGE IN BUDGETARY RESOURCES (INCLUSIVE OF RESOURCES FOR PENSIONS): | | | 1,691.2 |
| *FY 2014 tax figure reflects revised estimate after excluding FAS 109 delay, separately categorized below. | | | |
| **In FY 2014, \$50.6 M is dedicated to OPEB from debt service savings. | | | |
| ***In FY 2014, \$184 M in settlements in excess of \$10 M included in Projected Baseline Tax Collections. | | | |

The tables provided above and below outline the year-on-year changes in major revenue and spending categories. The following narrative summarizes the contributing factors to the annual changes adopted in the Governor's House 2 budget recommendations. As shown in the table, total budgetary resources in FY 2015 are estimated to increase by \$1.691 B from FY 2014 estimated levels. A corresponding increase in spending is recommended, and the FY 2015 Spending Summary section outlines the major changes adopted within these spending assumptions.

FY 2014 Budgetary Resources

FY 2015 Consensus Revenue

As noted in a previous section, the FY 2015 tax consensus figure announced on January 14, 2014 jointly by the Secretary of Administration and Finance and the Chairs of the House and Senate Committees for Ways and Means totaled \$24.337 B. After accounting for \$46 M of the FY 2014 tax projection (now \$22.230 B) coming from one-time resources generated by the delay of the FAS 109 deduction, the total baseline tax revenue growth before any tax law changes equals \$1.182 M.

FY 2015 Capital Gains

The estimated FY 2015 tax receipts associated with capital gains totals \$1.17 B, up from the FY 2014 assumption of \$1.06 B. Given the volatile nature of capital gains receipts, the Governor and the

Legislature worked to adopt a reform that restricts the amount of capital gains receipts that can be used for budgetary purposes in any given year. In FY 2014, that ceiling is \$1.023 B, but growing to \$1.048 B in FY 2015 (the threshold is subject to annual adjustment to reflect the average annual rate of growth in U. S. gross domestic product over the preceding five years).

FY 2015 Pension Contribution

The updated pension schedule, and the FY 2015 pension contribution associated with it, accounts for the full impact of the investment losses realized by the pension fund in 2008 as well as revised actuarial assumptions, most notably the adoption of a more conservative investment return assumption of 8.0%. After consultation with PERAC and the House and Senate, the Secretary for Administration and Finance established an updated funding schedule that requires a 10% increase in the FY 2015 pension contribution relative to 2014, with the new schedule specifying 10% increases also for 2016 and 2017 graduating down to 7% annual increases until the unfunded pension liability is fully funded by 2036. This makes for a \$163 M pension funding increase from FY 2014. Fully funding pensions by 2036 reflects an acceleration of the 2040 timetable currently required by law as recommended by state officials and budget watchdogs at the December 11, 2013 consensus revenue hearing.

FY 2015 Transfers of Tax Revenue

Under state law, specific amounts of the consensus revenue estimates are dedicated for annual transfers for dedicated purposes: the Massachusetts School Building Authority, the Massachusetts Bay Transportation Authority and the Workforce Training Fund. The first two receive an annual percentage of the state sales tax collections, while the third receives dedicated employer contributions to the Workforce Training Fund for grants to support incumbent worker training in the private sector. In total, the FY 2015 consensus forecast projects these transfers to equal \$1.605 B, an increase of \$55 M from the FY 2014 estimate of \$1.550 B. Similar to pensions, this annual increase has the effect of reducing budgetary resources when comparing year-on-year changes.

FY 2015 Non-Tax Revenues

As described in an earlier section, the three major categories of state non-tax revenues are: federal reimbursements, departmental revenues and transfers from non-budgetary sources. Total non-tax revenues are forecast to grow in FY 2015 by \$586 M, from \$14.603 B in FY 2014 to \$15.189 B in FY 2015. The major contributor to this increase is additional projected federal revenues (\$716 M) largely associated with state MassHealth (Medicaid) expenditures. The state is eligible to receive an enhanced federal Medicaid matching fund percentage associated with the federal Affordable Care Act (ACA) that became effective on January 1, 2014. Departmental revenues are forecast to increase modestly by \$120.7 M in FY 2014, or growth of 3.3%. Finally, increases in federal and departmental revenues are offset by a \$274.5 M reduction in budgetary transfers. The decrease is attributable to a lower Stabilization Fund withdrawal (from \$350 M in FY 2014 to \$175 M in FY 2015) and other one-time transfers from non-budgetary sources in FY 2013 that are budgeted to support one-time costs this year.

Prior Year Funds and Reserves

The FY 2014 budgetary resources currently include an estimated \$245.2 M in reserves largely funded through prior-year appropriations extended into FY 2014, mostly for one-time purposes. The Governor's FY 2015 House 2 recommendation does not assume that unspent funds in FY 2014 will be made available in FY 2015, and therefore at this time only projects a limited amount of reserves will be carried forward. The year-on-year impact is \$231.3 M less in budgetary resources than FY 2014; however, these reductions are typically offset by like reductions in spending.

FY 2015 One-Time Sources

As noted earlier, total estimated FY 2014 one-time resources equal \$667 M, or \$609.2 M after accounting for capital gains deposits into the Stabilization Fund. These compare to total FY 2015 one-time resources of \$334.4 M (\$224.6 M net after accounting for Stabilization Fund deposits).

| FYs 2014 and 2015 One-Time Resources | | | |
|---|-----------------------------|----------------------------|---------------------|
| \$s in millions | | | |
| | FY 2014 Revised* | FY 2015 House 2 | % Change |
| Budgetary Resources: | | | |
| FY 2013 Resources Used to Support Ongoing FY 2014 Costs | 31.0 | | |
| Stabilization Fund Withdrawal | 350.0 | 175.0 | |
| Stabilization Fund Interest | 5.8 | 10.7 | |
| Delay FAS 109 Deduction | 45.9 | 45.9 | |
| Medicaid Payment Schedule Changes | 41.0 | 13.0 | |
| Gaming Licensing Funds Supporting Ongoing Costs | 14.7 | 53.5 | |
| Sale of Assets | 30.0 | | |
| Procurement Savings | 30.0 | | |
| OPEB funded through Debt Service Reversions | 50.6 | | |
| Federal Revenues | | 32.3 | |
| Non-Budgetary Resources: | | | |
| Trust Fund Sweeps | 61.0 | 4.0 | |
| Quasi Public Contributions | 7.0 | | |
| TOTAL ONE TIME RESOURCES | 667.0 | 334.4 | -50% |
| Less: Stabilization Fund Deposits | (57.8) | (109.8) | |
| NET ONE TIME RESOURCES | 609.2 | 224.6 | -63% |

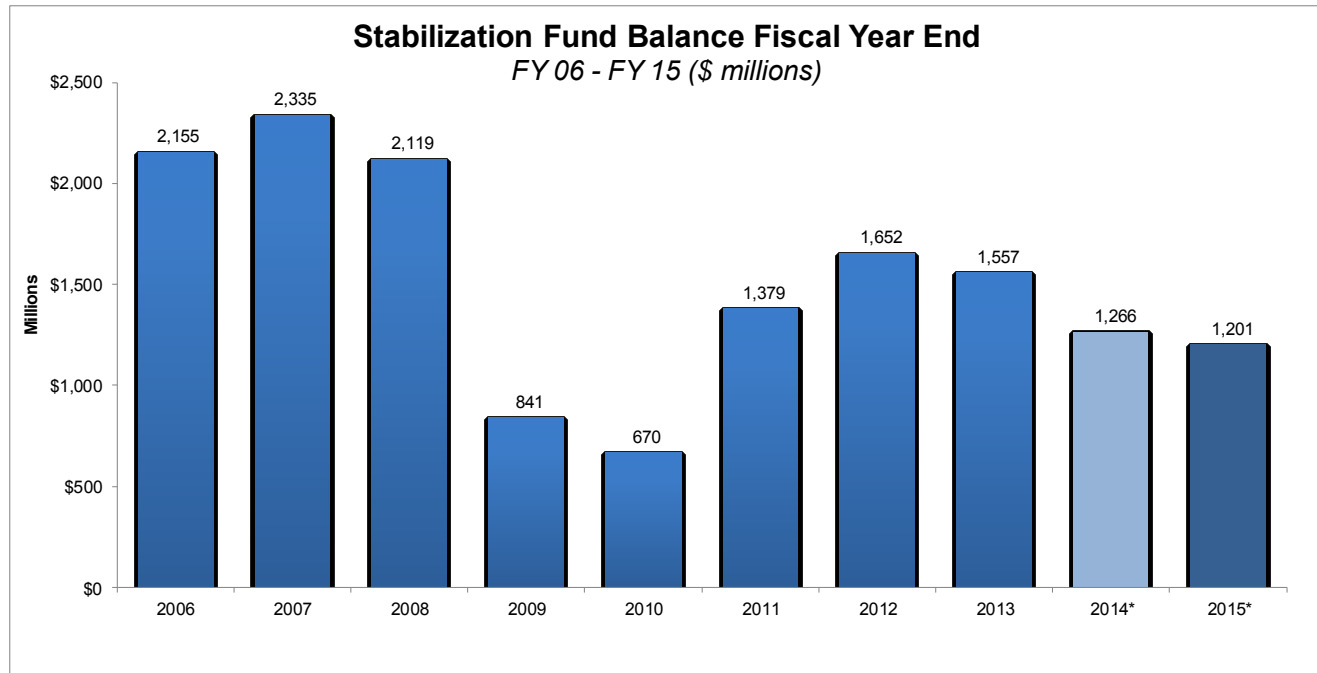
*Revised since the Governor signed the FY 2014 budget on July 12, 2013.

Assumed one-time resources in FY 2015 include:

- \$175 M in gross Stabilization Fund or "Rainy Day Fund" resources (a discussion of the rainy day fund follows in a later section). The Rainy Day Fund draw is \$175 M less than the FY 2014 budgeted assumption of \$350 M, and is projected to leave a balance of \$1.201 B in the fund at the close of FY 2015.
- \$53.5 M in gaming licensing funds that were originally budgeted to be collected in FY 2014 (a further discussion of gaming licensing revenues is provided below).
- \$45.6 M from again delaying the implementation of a corporate tax expenditure, known as FAS 109.
- \$13 M (net) in reduced state budgetary resources resulting from the restructuring of state funding for payments to hospitals. This shift reflects the timeline of grant awards for the Infrastructure and Capacity Building program, which have been paid out in the subsequent fall (following fiscal year) since FY 2013.
- \$32.3 M from one-time federal revenue opportunities, including TANF Contingency Fund revenue (\$31 M) and safety improvements at the Soldiers Homes (\$1.7 M) which are eligible for federal matching revenue.
- \$10.7 M of interest earned from the Stabilization Fund balance and redirected to the General Fund, consistent with prior fiscal years.
- \$4 M from the transfer of surplus non-budgetary fund resources to the General Fund. An outside section is included within the Governor's FY 2015 House 2 budget that authorizes the Secretary of Administration and Finance to close or sweep trust funds where he determines that such funds can be appropriately used to support the budget.

In total, the House 1 recommendation for FY 2014 relies on \$333 M less in one-time resources than those budgeted for FY 2014, a reduction of 50%. This amount, \$334 M, is within the sustainable amounts projected within the Executive Office for Administration and Finance's published long-term fiscal policy framework published originally in early 2012 and updated this month coinciding with the release of the FY 2015 budget.

Stabilization Fund



Projected ending balances.

The table provided above shows the year-end Stabilization Fund balances over the period FY 2005-15. The projected balances for Fiscal Years 2014 and 2015 are shown. Currently, FY 2014 is assumed to close the year with \$1.266 B in Stabilization Fund proceeds. This assumes a \$350M budgeted transfer to the General Fund, which is partially offset by the deposit of estimated capital gains revenues and the \$20 M repayment from gaming licensing revenues associated with the 2011 Expanded Gaming Act provision that used \$20 M of Stabilization Fund proceeds to fund the start-up costs for gaming oversight activities.

In FY 2015, the projected Stabilization Fund balance totals \$1.201 B. This reflects the assumed \$175 M in proposed draws to the General Fund and partially offset by \$122M in capital gains-receipts deposited into the Fund. Please note that, pursuant to state finance law, 5% of the amount deposited must then be transferred to the State Retiree Benefits Trust Fund and another 5% to the Commonwealth's Pension Liability Fund.

The projected year-end balance at the close of FY 2015 will leave Massachusetts one of the highest reserve balances in the nation. It also reflects the continued effort of the Governor and Legislature to adopt fiscal policies that responsibly limit the use of volatile or unsustainable resources (i.e. capital gains receipts) from general budgetary purposes. The Stabilization Fund has proven to be a critical tool over the past several fiscal years to help mitigate some of the impact of reduced tax collections resulting from the 2008-09 economic recession. It is important to continue policies that support a sufficient fund balance and ensure resources are available for the future as state continues to recover from an unprecedented fiscal collapse.

FY 2015 New Tax Revenues

The Patrick Administration proposes the following changes to our tax system to enhance public health and close loopholes:

1. Collecting sales tax on candy and soda purchases, and using the associated revenue to fund the Commonwealth Health and Prevention Fund, which will support public health programs

FY 2015 Governor's Budget Recommendation

2. Imposing the room occupancy tax on the mark-up that room resellers like online travel websites, as well as on transient rentals
3. Applying the corporate tax rate to pass-through entities owned by insurance companies and security corporations

FY 2014 Gaming Licensing Revenues

The FY 2014 budget assumed \$83 M in budgetary revenues associated with the licensing of 3 gaming facilities (2 "Category 1" Licensees and 1 "Category 2" Licensee). Of this amount, approximately \$32 M was used to support on-going budgetary expenses and was listed among the \$696 M in projected FY 2014 one-time resources at the time the Governor signed the budget into law.

The Massachusetts Gaming Commission (MGC) has published a plan that indicates that two Category 1 licenses and one Category 2 license will be awarded by June 30, 2014. However, the Governor's FY 2015 budget reflects the fact that while the FY 2014 budget assumed two Category 1 licenses and one Category 2 license awarded in FY 2014, some of the dates for award are very close to the end of the fiscal year. Consistent with good fiscal planning, the budget assumes one Category 1 license fee in each of FY 2014 and FY 2015. This spreads any fiscal risk associated with the timing of the award of these licenses and the collection of the associated fees.

The minimum Category 1 license fee is \$85 M, and a Category 2 license fee totals at least \$25 M, generating at least \$110 M in gaming licensing revenues in FY 2014 and \$85 M in FY 2015. Under the existing laws (Chapter 194 of 2011) the first \$20 M of any gaming licensing must repay the Stabilization Fund for the "start-up costs" for the MGC and the Community Mitigation and Transportation Funds must be fully capitalized first. This leaves \$47 M in licensing revenues to be distributed via the prescribed allocation under Section 93 of Chapter 194 in FY 2014. Of this amount, \$29.65 M is projected to be available for state budgetary purposes. Though only \$47 M of the \$83 M in revenue is available in FY 2014, all \$83 M of related expenditures will occur, consistent with the budgetary fund construct under state finance law.

The remaining \$53.5 M in budgeted revenue (associated with the \$85 M in licensing revenue from the second Category 1 establishment) will move from FY 2014 to FY 2015. In FY 2015, the General Fund will be reimbursed for those FY 2014 expenditures not supported by licensing revenue from second Category 1 license due to timing complexities.

| FY 2014 Budget Assumption* | | | | | | | | | | | | |
|-------------------------------------|---------------|---------------------------------|--|----------------------------------|--|---------------------------------|-------------------------------------|---------------------------|---|---|--|---------------|
| License | Revenue | Stabilization Fund ¹ | Community Mitigation Fund ¹ | Transportation Fund ¹ | Local Capital Projects Fund ² | Manufacturing Fund ² | Community College Fund ² | Tourism Fund ² | Local Aid Stabilization Fund ² | Healthcare Payment Reform Fund ¹ | Race Horse Development Fund ¹ | Total |
| Category 2, 2 Category 1 | \$195.00 | \$20.00 | \$17.50 | \$25.38 | \$19.25 | \$22.75 | \$29.75 | \$2.63 | \$8.75 | \$40.25 | \$8.75 | \$195.00 |
| FY 2015 House 2 Update | | | | | | | | | | | | |
| License | Revenue | Stabilization Fund ¹ | Community Mitigation Fund ¹ | Transportation Fund ¹ | Local Capital Projects Fund ² | Manufacturing Fund ² | Community College Fund ² | Tourism Fund ² | Local Aid Stabilization Fund ² | Healthcare Payment Reform Fund ¹ | Race Horse Development Fund ¹ | Total |
| Category 2, 1 Category 1 | 110.00 | 20.00 | 17.50 | 25.38 | 6.87 | 8.11 | 10.61 | 0.94 | 3.12 | 14.35 | 3.12 | 110.00 |
| Reduction in FY14 Licensing Revenue | | | | | (12.38) | (14.64) | (19.14) | (1.69) | (5.63) | (25.90) | (5.63) | (85.00) |
| Category 1 License | 85.00 | | 0.00 | 0.00 | 12.38 | 14.64 | 19.14 | 1.69 | 5.63 | 25.90 | 5.63 | 85.00 |
| Two Year Total | 195.00 | 20.00 | 17.50 | 25.38 | 19.25 | 22.75 | 29.75 | 2.63 | 8.75 | 40.25 | 8.75 | 195.00 |

* Figures in millions
 on-budgetary fund
 budgetary fund

The table above outlines the projected FY 2014 and FY 2015 licensing revenues and distributions, per Chapter 194.

Modernize Bottle Redemption in FY 2014

The Massachusetts Bottle Bill, enacted in 1982, is designed to encourage consumers to return their empty soda and beer containers by means of a redeemable \$0.05 deposit. The \$0.05 refundable deposit is placed on all carbonated sodas, beer and malt beverages. Most bottle deposits are redeemed through two types of sites, redemption centers and large retail stores. When the Bottle Bill was enacted in 1982, the beverages covered by the law were limited to carbonated soft drinks, mineral water, beer and other malt beverages. Since that time, the beverage market has changed with bottled water, fruit drinks, iced tea and sports drinks now being some of the most popular choices available. However, these non-carbonated beverages are not covered by the Bottle Bill and often end up in landfills or along the side of the road.

By revising the definition of “beverages” in Massachusetts General Law, the Bottle Bill can be brought up to date. Consumers will be required to pay an additional \$0.05 cents on water, flavored waters, iced teas, coffee based drinks and sports drinks. The amounts paid for deposits for expanded beverages will be returned to consumers if they return the empty bottles for recycling. The Governor’s FY 2015 budget assumes that by adopting these changes, the state will collect at least \$24 M in additional revenues next year, allowing for \$4 M in investments in state recycling coordination and redemption efforts.

FY 2015 Spending Summary

FY 2015 Spending Growth

The Governor’s FY 2015 budget is balanced and fiscally responsible. Total state FY 2015 spending is projected to be \$36.373 B (or \$38.166 B after including the annual pension contribution), a 4.88% increase from FY 2014 estimated spending.

| State Budgetary Spending* | | |
|---------------------------|--------|----------|
| FYs 2004-2015 | | |
| \$s in millions | | |
| FY | Amount | % Growth |
| 2004 | 22,146 | N/A |
| 2005 | 22,562 | 1.88% |
| 2006 | 24,310 | 7.75% |
| 2007 | 27,588 | 13.48% |
| 2008 | 29,410 | 6.60% |
| 2009 | 29,292 | -0.40% |
| 2010 | 29,047 | -0.84% |
| 2011 | 30,636 | 5.47% |
| 2012 | 30,976 | 1.11% |
| 2013 | 32,342 | 4.41% |
| 2014 | 34,682 | 7.24% |
| 2015 | 36,373 | 4.88% |

*excludes revenue dedicated for pensions

In the fiscal years following the fiscal downturn of 2008-09 (which began in state FY 2009) total state spending growth has averaged 3.12% annual growth through FY 2015. This compares to 6.13% in average annual growth in the 5 years preceding FY 2009.

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | | |
|---|----------------------------|--------------------------|-------------------------|--------------|--|
| Non-Executive Branch Agencies | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change | |
| Judiciary | \$ 827,947,570 | \$ 850,979,460 | \$ 23,031,890 | 2.8% | |
| Sheriffs | \$ 524,394,493 | \$ 552,958,291 | \$ 28,563,798 | 5.4% | |
| District Attorneys | \$ 102,919,091 | \$ 104,353,574 | \$ 1,434,483 | 1.4% | |
| Lottery Commission | \$ 90,967,942 | \$ 94,380,306 | \$ 3,412,364 | 3.8% | |
| Comptroller | \$ 16,808,090 | \$ 14,014,338 | \$ (2,793,752) | -16.6% | |
| Legislature | \$ 74,273,870 | \$ 66,681,647 | \$ (7,592,223) | -10.2% | |
| Other Constitutional Offices | \$ 200,359,417 | \$ 202,717,233 | \$ 2,357,817 | 1.2% | |
| Debt Service | \$ 2,432,654,868 | \$ 2,508,321,987 | \$ 75,667,119 | 3.1% | |
| Administration and Finance | \$ 521,373,370 | \$ 363,925,764 | \$ (157,447,606) | -30.2% | |
| Group Insurance Commission | \$ 1,785,369,676 | \$ 1,889,502,875 | \$ 104,133,199 | 7.3% | |
| Energy and Environmental Affairs | \$ 220,511,930 | \$ 229,746,751 | \$ 9,234,820 | 4.2% | |
| Health and Human Services | \$ 5,149,454,541 | \$ 5,447,621,991 | \$ 298,167,450 | 5.8% | |
| MassHealth | \$ 12,120,786,014 | \$ 13,506,437,942 | \$ 1,385,651,928 | 11.4% | |
| Housing and Economic Development | \$ 557,423,011 | \$ 478,112,312 | \$ (79,310,700) | -14.2% | |
| Labor and Workforce Development | \$ 54,879,588 | \$ 47,854,348 | \$ (7,025,240) | -12.8% | |
| Higher Education Campuses | \$ 960,654,740 | \$ 1,028,942,126 | \$ 68,287,386 | 7.1% | |
| Executive Office of Education | \$ 1,248,171,947 | \$ 1,260,573,381 | \$ 12,401,434 | 1.0% | |
| K-12 Aid (Chapter 70) | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% | |
| Local Aid | \$ 948,650,293 | \$ 947,000,293 | \$ (1,650,000) | -0.2% | |
| Public Safety | \$ 1,012,405,284 | \$ 1,013,906,187 | \$ 1,500,903 | 0.1% | |
| Health Connector Authority | \$ 340,078,633 | \$ - | \$ (340,078,633) | -100.0% | |
| Transfers for Payments to Hospitals and Providers | \$ 661,474,470 | \$ 622,261,307 | \$ (39,213,163) | -5.9% | |
| Other Transfers to Non-Budgetary Funds | \$ 2,625,000 | \$ 9,753,272 | \$ 7,128,272 | 271.6% | |
| Transportation | \$ 591,753,731 | \$ 732,753,731 | \$ 141,000,000 | 23.8% | |
| Total Appropriated Spending | \$ 34,747,152,159 | \$ 36,373,495,301 | \$ 1,626,343,141 | 4.7% | |
| State Pension Contribution | \$ 1,630,000,000 | \$ 1,793,000,000 | \$ 163,000,000 | 10.0% | |
| Total Spending Including Pensions | \$ 36,377,152,159 | \$ 38,166,495,301 | \$ 1,789,343,141 | 4.9% | |

Listed in the table above is a summary of the major spending categories of the state budget with FY 2014 estimated spending and FY 2015 House 2 budget levels, as well as dollar and percent changes year-on-year. Description of major highlights and policy changes are provided below.

Non-Executive Branch Agencies

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | | |
|--|----------------------------|-------------------------|----------------------|-------------|--|
| Non-Executive Branch Agencies | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change | |
| Judiciary | \$ 827,947,570 | \$ 850,979,460 | \$ 23,031,890 | 2.8% | |
| Sheriffs | \$ 524,444,493 | \$ 552,958,291 | \$ 28,513,798 | 5.4% | |
| District Attorneys | \$ 102,919,091 | \$ 104,353,574 | \$ 1,434,483 | 1.4% | |
| Lottery Commission | \$ 90,967,942 | \$ 94,380,306 | \$ 3,412,364 | 3.8% | |
| Comptroller | \$ 16,808,090 | \$ 14,014,338 | \$ (2,793,752) | -16.6% | |
| Legislature | \$ 74,273,870 | \$ 66,681,647 | \$ (7,592,223) | -10.2% | |
| Other Constitutional Offices | \$ 200,359,417 | \$ 202,717,233 | \$ 2,357,817 | 1.2% | |
| Total Spending | \$ 1,837,720,473 | \$ 1,886,084,849 | \$ 48,364,377 | 2.6% | |

Agencies outside of the Executive branch include: the judicial agencies, such the Supreme Judicial Court, the Trial Courts, and the Committee for Public Counsel Services (CPCS); District Attorneys; State Sheriffs; Constitutional Officers; the Lottery Division; the State Comptroller and the Legislature, comprising of \$1.914 B of the FY 2015 budget recommendations. Some areas of note include –

- **Judiciary** – The Governor's FY 2015 budget funds the full annualized cost of the judicial salary increase entitled to judges and clerks per the FY 2014 budget in addition to a small across the board increase for Judiciary. The Governor's budget also includes \$2.7 M to support the development of eight regional specialty courts across the state. In addition, the FY 2015 budget funds the main administrative accounts of CPCS at a 2% increase over their FY 2014

appropriation, while funding the CPCS caseload accounts at their agency requested level. The Governor's budget also restores aid to the Massachusetts Legal Assistance Corporation in FY 2015 to \$14 M, a \$1 M increase over FY 2014.

- **Sheriffs** – The Governor's FY 2015 budget provides 1 percent increases for the main operating funding appropriations for state sheriffs' offices. The Governor's FY 2015 funding level assumes that supplemental funding will be provided for a number of sheriffs in FY 2014 to more closely align with sheriff facility costs needed for the full year. Three sheriffs received an additional investment in the FY 2015 budget; Bristol, Middlesex and Hampden. Bristol is receiving an investment of \$4 M to fund the legislative initiative begun in FY 2013 to bring correctional officer salaries up to date with similar counties. Middlesex is receiving a \$2.2 M investment to offset one-time and ongoing costs associated with the operations of the expanded Middlesex House of Correction to accommodate the closure of the jail in the Cambridge Edward J Sullivan Courthouse. Hampden is receiving a \$1.9 M investment for the operations of the expanded Western Massachusetts Regional Women's Correctional Center (WMRWCC), which is to be complete in April 2014. Upon completion, the WMRWCC will house all women sentenced to a House of Correction or awaiting a trial in Hampden, Worcester, Hampshire, Franklin, and Berkshire County, which will take pressure off the crowded MCI Framingham Women's Facility.
- **District Attorneys** – Funding for District Attorneys' main operational accounts is increased in FY 2015 by 2 percent from their FY 2014 appropriations, consistent with other independent and constitutional offices.
- **Other Constitutional Officers** – With limited exceptions, the funding for the accounts of the Constitutional offices has been funded at 2 percent above FY 2014 appropriations. The Secretary of State's elections accounts have been funded to their agency requested level in order to account for upcoming statewide elections in FY 2015.
- **Lottery** – The state's Lottery Commission oversees the state's various lottery and gaming operations. The Commission generates over \$1 B in annual state budgetary revenue, offset by the Lottery's operating costs which total over \$90 M. Funding in FY 2015 for Lottery includes an increase of \$3 M for advertising. The Commission estimates this investment will increase revenues by \$10 M.
- **Governor** – Funding for the Governor's office is increased by 2 percent from their FY 2014 appropriation. The FY 2015 budget also provides the Governor's office \$250 K to cover the costs of the gubernatorial transition. Additionally, the Office of the Child Advocate is funded at \$500 K, a 64 percent increase over their FY 2014 appropriation, in order to help state agencies provide and care for the Commonwealth's young and at-risk children.
- **Legislature** – The funding for the annual operations of the House, Senate and Joint Legislative activities in FY 2015 is increased by 2 percent from FY 2014 appropriations.

Debt Service

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|-------------------------|----------------------|-------------|
| Consolidated Debt Service | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| Debt Service | \$ 2,432,429,681 | \$ 2,508,321,987 | \$ 75,892,306 | 3.1% |
| Total Spending | \$ 2,432,429,681 | \$ 2,508,321,987 | \$ 75,892,306 | 3.1% |

In order to fund the necessary improvements to the state's transportation infrastructure as well as to make investments in our higher education system, housing, high-tech industries and other job-creating projects, the state borrows money through the issuance of bonds and pays the borrowing back with annual debt service appropriations in the operating budget.

State debt service spending in FY 2015 totals \$2.508 B, an increase of 3.1% from FY 2014 levels of \$2.432 B. Most debt service costs are funded from within the budget of the State Treasurer, who is responsible for the day-to-day oversight of all Commonwealth debt service and debt financing activities. In a limited number of cases, annual debt service payments are from appropriations within A&F.

Successful management of the state's debt service has resulted in a Commonwealth credit rating of AA+ and Aa1 from Standard & Poor's, Moody's and Fitch, which is the highest credit standing in Massachusetts history.

Executive Branch Agencies

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | | |
|---|----------------------------|--------------------------|-------------------------|-------------|--|
| Executive Branch Agencies | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change | |
| Administration and Finance | \$ 521,373,370 | \$ 363,925,764 | \$ (157,447,606) | -30.2% | |
| Group Insurance Commission | \$ 1,365,008,263 | \$ 1,465,334,234 | \$ 100,325,971 | 7.3% | |
| Energy and Environmental Affairs | \$ 220,511,930 | \$ 229,746,751 | \$ 9,234,820 | 4.2% | |
| Health and Human Services | \$ 5,149,454,541 | \$ 5,447,621,991 | \$ 298,167,450 | 5.8% | |
| MassHealth | \$ 12,120,786,014 | \$ 13,506,437,942 | \$ 1,385,651,928 | 11.4% | |
| Housing and Economic Development | \$ 557,423,011 | \$ 478,112,312 | \$ (79,310,700) | -14.2% | |
| Labor and Workforce Development | \$ 54,879,588 | \$ 47,854,348 | \$ (7,025,240) | -12.8% | |
| Higher Education Campuses | \$ 960,654,740 | \$ 1,028,942,126 | \$ 68,287,386 | 7.1% | |
| Executive Office of Education | \$ 1,248,171,947 | \$ 1,260,573,381 | \$ 12,401,434 | 1.0% | |
| K-12 Aid (Chapter 70) | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% | |
| Local Aid | \$ 948,650,293 | \$ 947,000,293 | \$ (1,650,000) | -0.2% | |
| Public Safety | \$ 1,012,405,284 | \$ 1,013,906,187 | \$ 1,500,903 | 0.1% | |
| Health Connector Authority | \$ 340,078,633 | \$ - | \$ (340,078,633) | -100.0% | |
| Transfers for Payments to Hospitals and Providers | \$ 661,474,470 | \$ 622,261,307 | \$ (39,213,163) | -5.9% | |
| Other Transfers to Non-Budgetary Funds | \$ 2,625,000 | \$ 9,753,272 | \$ 7,128,272 | 271.6% | |
| State Retiree Health Care | \$ 420,361,413 | \$ 424,168,641 | \$ 3,807,228 | 0.9% | |
| Transportation | \$ 591,753,731 | \$ 732,753,731 | \$ 141,000,000 | 23.8% | |
| Total Spending | \$ 30,476,826,819 | \$ 31,979,088,465 | \$ 1,502,261,645 | 4.9% | |

Direct funding for Executive Branch Agencies for programs and services or funding that falls within each of these government areas totals \$31.979 B in FY 2015, which represents an increase of 4.9% from FY 2014 spending. Highlights of major funding changes in the Executive Branch include:

- **Executive Office of Education (EOE)** – The FY 2015 budget for the Secretariat of Education will make significant investments in closing achievement gaps across the entire educational spectrum. These investments:

Demonstrate a commitment to early education and care by both supporting and increasing access to high-quality child care programs, through:

- \$40.2 M to support children already served by the Department of Early Education and Care;
- \$15 M to increase access to high-quality early education programs for 1,700 qualified children from birth to age five;
- \$2.5 M to ensure that increased access is paired with providing high-quality early education environments for children and youth; and
- \$800 K to ensure children are enrolled in safe and supportive early education programs through additional oversight of child care centers.

- This budget supports universal third grade literacy as an important predictor of future academic success, through increased educational opportunities for children ages four and five, by adding:
 - \$3.1 M to increase and refocus kindergarten expansion grants to provide communities without full-day kindergarten classrooms, the ability to offer such classrooms;
 - \$2 M to provide competitive start-up grants for school districts interested in establishing pre-kindergarten classrooms; and
 - \$2 M to increase Chapter 70 to fully finance pre-kindergarten costs for school districts who offer pre-kindergarten classrooms.
- The budget also prioritizes closing persistent achievement gaps is essential to ensuring all students have an opportunity to succeed by including:
 - \$4.5 M to provide additional educational enrichment opportunities for high-need populations by providing targeted grants for middle schools in low-income school districts;
 - \$3.1 M to increase the resources for schools interested in pursuing ways to improve student performance through the Innovation Schools initiative; and \$1.25 M to support locally-designed and implemented initiatives in the Gateway Cities.

Finally, the FY 2015 budget increases state support to the University of Massachusetts, the state universities, and community colleges. This collaboration between the Administration and the campuses creates a shared sense of responsibility to provide high-quality services to all students while maintaining affordability. This increased funding, a total of \$68.4 M in FY 2015, will allow the campuses to maintain their delivery of educational and other services to develop our future leaders. The General Fund itself is actually funding an \$87.5 M increased investment for the public college system, as it has picked up the costs of \$20 M provided to the community colleges in one-time gaming funds in FY 2014. This is on top of a \$97 M increased investment in our public college system last year.

- ***Executive Office of Health and Human Services (EOHHS)*** – The non-health insurance portion of the EOHHS budget totals \$6.1 B in FY 2015 (including non-budgetary transfers). Funding under EOHHS supports a wide range of services, including transitional assistance to families, services to persons with disabilities, care for veterans, public health and disease prevention activities, protection of children at risk of abuse or neglect and care for youthful offenders. Recognizing the importance of maintaining critical safety net programs and services, the Governor's budget preserves funding within EOHHS for programs and services that protect the state's most vulnerable residents. Projected caseload needs for critical safety net programs are fully supported in FY 2015 including substance abuse services, cash and nutritional assistance for low income families, early health screenings for children, suicide prevention services and domestic violence prevention treatment.

The Governor's FY 2015 budget is committed to protecting human service workers and the vulnerable populations they serve. This budget provides an investment of \$163 M above FY 2014 to support human services and is committed to the full implementation of the Chapter 257 legislation to ensure fair and adequate payment rates for health care providers. In total, the FY 2015 budget supports \$213 M for rates to providers implemented in FY 2014 or planned for FY 2015, as well as \$7 M to continue the commitment to salary equity for human service workers not yet affected by rate reform. In the face of the toughest economic times in a generation, the Governor is committed to protecting services for our most vulnerable residents and the workers committed to ensuring their care.

To promote strong, safe communities for youth and families, the Governor's FY 2015 budget also makes significant investments in positive youth development and youth violence prevention efforts as well as community supports for families. The budget includes:

- \$9.5 M for the Safe and Successful Youth Initiative (SSYI), which targets at-risk youth to prevent and interrupt community violence.

- \$7 M for the Administration's landmark Juvenile Justice Pay for Success Initiative to prevent youth recidivism into our adult criminal justice system and paying only after results are achieved.
- \$9.2 M to support capacity building and operational improvements at the Department of Children and Families to better serve families
- \$15 M to implement "Raise the Age" legislation signed by the Governor in 2013 that changes juvenile jurisdiction laws to support the rehabilitation of young people through age 18
- Full funding for FY14 investments in Family Resource Centers (FRC), improving community access to family and youth support services and ensuring there is no "wrong door" for a family in need. The FRC funding increase of \$7.1 M will help these community-based centers address child abuse and neglect, juvenile delinquency, mental illness, poverty, substance abuse and other special needs. Family Resource Centers will serve children up to the age of 18 (up from 12 currently) and have a presence in every county by FY 2016.
- **Executive Office of Public Safety and Security (EOPSS)** – The Governor's budget outlines a comprehensive framework for reentry of released inmates that focuses on reclassifying higher-security and lower-security custody inmates, as well as a collaborative "step-down" program that works with state Sheriffs to allow select inmates to complete their sentences at county-located Houses of Corrections and utilize educational, vocational, and life skill programs by investing an additional \$2.1 M in reentry reform. The Governor's FY 2015 budget also funds projected cost increases by state agencies that provide an array of public safety services to the state's residents, including but not limited to highway patrols and policing, corrections and inmate re-entry services. The Governor's budget also makes a crucial down payment on the implementation of a new State Police cadet class, which will supplement the 150 newly commissioned officers expected to graduate from this current fiscal year's class. The Chief Medical Examiner received \$1 M investment in FY 2015 which will be leveraged to reduce caseload demands and better allocate personnel resources.
- **Massachusetts Department of Transportation (MassDOT)** – In addition to the a capital investment of \$12.4 B over 5 years, a \$141 M increase is included in the Governor's FY 2015 budget for MassDOT and the Massachusetts Bay Transportation Authority (MBTA) above the FY 2014 GAA level. This funding is consistent with the framework established by the 2013 Transportation Finance Bill. In FY 2015, this investment will:
 - Continue to eliminate the MBTA's structural operating deficit, which prior to FY 2014 had been solved through the use of one-time, unsustainable funding sources;
 - Continue modest MBTA service enhancements including bus and subway service improvements; and
 - End the decades-old practice of using borrowed funds (bonds) to pay for personnel, which will allow millions in additional capital investment; and
 - Continue the practice established in FY 2014 of not funding Regional Transit Authorities (RTAs) in arrears. Prior to FY 2014, RTA's were funded by the Commonwealth in this manner, which required RTAs to take on addition short-term debt in order to fund annual operating costs. The funding change, continued in FY 2015, will decrease costs to the taxpayers and customers.
- **Executive Office of Energy and Environmental Affairs (EOEEA)** – FY 2015 funding for EOEEA funds anticipated cost increases for the executive office and the six agencies that make up the EOEEA Secretariat. The Governor's FY 2015 budget expands the Bottle Bill to include a 5 cent deposit on non-carbonated beverage containers such as bottled water, juices and sports drinks and provides \$4 M to the Department of Environmental Protection in order to increase

recycling promotion and coordination efforts throughout the Commonwealth. The Governor proposes to invest \$2 M in the operating budget to enhance the Commonwealth's preparedness for climate change, in addition to \$50 M in capital and trust resources already dedicated to this initiative. Lastly, the Governor's FY 2015 budget provides \$920 K in new funding to the Department of Conservation and Recreation (DCR) to hire additional seasonal staff to ensure that the Commonwealth's parks, pools, beaches and facilities are well-staffed and operated effectively.

- **Executive Office of Housing and Economic Development (EOHED)** – FY 2015 funding for EOHED is approximately \$79 M less than FY 2014 estimated spending, reflecting a decrease in projected spending on emergency services for homeless families in the Commonwealth. The decrease is due to the ending of the HomeBASE Rental Assistance Program (\$38 M) and a reduction in funding for motels (\$39 M). The Governor's budget does increase funding for the EA Shelter Program by \$64 M and level funds other housing benefit programs under the Department of Housing and Community Development (DHCD) to provide the most efficient and effective response to any housing emergency. The Governor's budget also includes a provision to forward-fund the federal Low Income Home Energy Assistance Program (LIHEAP).
- **Executive Office of Labor and Workforce Development (EOLWD)** – Compared to the FY 2014 estimated spending, funding at EOLWD is decreased by 6.9 percent in FY 2015. This is primarily due to the fact that there was \$19 M in funding available in FY 2014 for the Summer Jobs for At-Risk Youth Program, \$10 M of which was used to fund the program for the summer of 2013 and \$9 M is dedicated to forward-funding the summer of 2014. The FY 2015 budget increased investments proposed by the Governor for the Summer Jobs program by \$3 M to \$12 M, which subsidizes employment opportunities for low-income youth primarily during the 2015 summer.
- **Executive Office for Administration and Finance (A&F)** – Annual funding levels under A&F can vary greatly from year-to-year since A&F typically houses reserve or other short-term appropriations that are not sustained annually. In FY 2015, \$7 M in additional funding is provided to fund the continuation of the successful sinking fund that is supporting the nation-leading pay for performance social innovation funding initiatives. This will continue support for two initiatives that target lowering state costs while improving outcomes for youth offenders and unaccompanied adults who face chronic homelessness.

School Aid for Public K-12 Education (Chapter 70)

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|-------------------------|----------------------|-------------|
| K-12 (Chapter 70) | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| K-12 (Chapter 70) | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% |
| Total Spending | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% |

Throughout his Administration, Governor Patrick has prioritized funding for Chapter 70 as the primary method by which the state finances local K-12 public education. An increase of \$100 M in Chapter 70 funding will bring this vital support for communities to an unprecedented \$4.4 B. This level of funding represents a \$1.1 B M, or 34% increase in Chapter 70 funding from the beginning of the Patrick Administration.

The FY 2015 Chapter 70 funding level makes significant progress in the phase-in of the education reforms that first began in FY 2007, fully funds all schools at foundation levels, ensures that all local educational authorities (LEA's) will receive an increase of at least \$25 per pupil and will uncapped the

number of pre-kindergarten students counted in a districts foundation enrollment. The FY 2015 distribution of Chapter 70 will increase equity and access among all school districts and is intended to allow LEA's the flexibility to fund programs that are needed most in their districts, whether special education, MCAS support, literacy programming or other vital supports.

MassHealth (Medicaid) Spending

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|--------------------------|-------------------------|--------------|
| MassHealth (Medicaid) | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| MassHealth (Medicaid) | \$ 12,120,786,014 | \$ 13,506,437,942 | \$ 1,385,651,928 | 11.4% |
| Total Spending | \$ 12,120,786,014 | \$ 13,506,437,942 | \$ 1,385,651,928 | 11.4% |

MassHealth, the Commonwealth's Medicaid program, provides health care to 1.6 M low-income children and families, low-income adults, disabled individuals and low-income elders across the Commonwealth. The FY 2014 budget supported the first six months of ACA implementation at MassHealth. The Governor's FY 2015 budget supports the annualized costs of the ACA expansion population and ongoing enrollment.

The budget includes \$1.7 B for the projected 345,000 members in the ACA expansion population, with the majority of this spending offset by federal revenue. The net gain to the Commonwealth for members previously in subsidized coverage is \$350 M in additional federal revenue due to an increase in the Federal Medical Assistance Percentage (FMAP) for this population to 75% from the current 50%. The FY 2015 budget creates the Health Insurance Expansion Fund to ensure this additional federal revenue supports the expansion of health insurance to low-income residents of the Commonwealth.

The Governor's FY 2015 budget for programmatic spending at MassHealth is \$13.5 B (\$6.3 B net of federal reimbursement), which is an 11.2% increase over FY 2014 estimated spending. MassHealth's FY 2015 spending is only 4% higher than FY 2014 spending when excluding investments for provider and hospital rate increases and partial-year restoration of coverage for dentures in FY 2015, enrollment increases for the non-expansion population, the full-year costs of FY 2014 investments in hospital rates and annualized ACA costs.

The budget supports new investments in provider rates, such as 2% capitation rate increases for Managed Care Organizations (MCO), including those in the MassHealth CarePlus program, and 2% capitation rate increases for the Massachusetts Behavioral Health Partnership (MBHP). The budget also includes funding for 2% increases in base hospital rates and increases to fee-for-service provider rates, and restoration of coverage for dentures in the second half of the fiscal year.

Most of the investments from the FY 2014 budget are maintained in the Governor's FY 2015 budget, including \$67 M for increases to base hospital rates and alternative payment methodology (APM) participation, \$33.6 M to restore coverage for fillings for adult members and \$22 M for supplemental payments to specialty pediatric and rehabilitation hospitals. In addition to MassHealth's programmatic appropriations, the budget includes \$34.3 M to provide necessary resources for community support services and coordination to persons with Acquired Brain Injuries (ABI) who may have previously been residing in long-term care facilities.

Group Insurance Commission

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|-------------------------|-----------------------|-------------|
| Group Insurance Commission | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| Group Insurance Commission | \$ 1,365,008,263 | \$ 1,465,334,234 | \$ 100,325,971 | 7.3% |
| State Retiree Health Care | \$ 420,361,413 | \$ 424,168,641 | \$ 3,807,228 | 0.9% |
| Total Spending | \$ 1,785,369,676 | \$ 1,889,502,875 | \$ 104,133,199 | 5.8% |

The Group Insurance Commission (GIC) provides high value health insurance and other benefits to Commonwealth and certain public authorities' employees and retirees as well as their survivors and dependents. The GIC also provides health-only benefits to participating municipalities' employees and retirees and their survivors and dependents.

The GIC continues to work closely with its health plans to control costs and initiated a health plan procurement that is estimated to save the Commonwealth \$1.29 B through FY 2018. Savings will be achieved by reducing the average annual growth in spending from 6% to 2% in FY 2015, saving over \$75 M, and holding growth at or below 2% thereafter. Through the procurement, the GIC required plans to establish and share risk with a network of risk-bearing provider organizations (IRBOs) sufficient to cover 75% of GIC covered lives by FY 2016. The use of IRBOs promotes more efficient, high value health care delivery as envisioned by Chapter 224, the state's landmark health care cost-containment legislation.

Through the success of municipal health care reform, the GIC has opened its doors to the cities and towns of the Commonwealth to participate in the Commission's health insurance program. Since the Administration proposed municipal health reform in January 2011, more than 260 municipalities and regional school districts came to agreements with employees, achieving premium savings totaling more than \$237 M. Since then, 23 more cities, towns and school districts joined the GIC, 12 used the new reform's expedited decision-making process and 11 joined as a result of negotiations inspired by the reform process. The GIC now has 49 cities, towns and school district members with more than 45,000 municipal subscribers.

Health Connector Authority

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|-----------------|-------------------------|----------------|
| Health Connector Authority | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| Health Connector Authority | \$ 340,078,633 | \$ - | \$ (340,078,633) | -100.0% |
| Total Spending | \$ 340,078,633 | \$ - | \$ (340,078,633) | -100.0% |

The Health Connector, the Commonwealth's health insurance Marketplace, offers affordable, high quality health insurance to the individual and small group health insurance market. Prior to the federal Affordable Care Act (ACA), the Health Connector administered the Commonwealth Care health plan for low-income individuals who were ineligible for MassHealth. The Patrick Administration is phasing out Commonwealth Care in FY 2014 in a manner which ensures continuous coverage for those transitioning into the ConnectorCare program.

Under the ACA, many individuals and families who shop for a health plan through the Marketplace are eligible for federal tax credits and state subsidies. Those with household incomes below 400% FPL (federal poverty level) may be eligible for federal Advanced Premium Tax Credits, while those below 300% FPL may additionally be eligible for state ConnectorCare subsidies to reduce consumer premiums and out-of-pocket expenses to levels consistent with the Commonwealth Care program. A monthly average of approximately 145,000 individuals with incomes up to 300% FPL are expected to be enrolled in the ConnectorCare program. Because FY 2015 is the first full fiscal year of subsidy implementation, the Governor's FY 2015 budget has increased resources dedicated directly to the Commonwealth Care Trust Fund for the ConnectorCare program to \$235 M. Further, the employer

assessment that was previously used to help finance health insurance for the unemployed through the Medical Security Program (MSP) will now help to defray the cost of the ConnectorCare program. The combination of federal resources, enhanced Employer Responsibility revenue, tobacco tax collections and other financing mechanisms deposited directly in the Connector's trust fund mean that the agency requires no subsidy from the General Fund in FY 2015.

Unrestricted General Government Aid

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|--|----------------------------|-------------------------|----------------------|-------------|
| Unrestricted General Government Aid | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| Local Aid (UGGA) | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% |
| Total Spending | \$ 4,301,214,591 | \$ 4,400,696,186 | \$ 99,481,595 | 2.3% |

Unrestricted General Government Aid (UGGA) and state payments in lieu of taxes (PILOT) aid make up unrestricted local government aid. UGGA will be preserved at \$920 M, after an increase in \$21.3 M in FY 2014, the first increase in unrestricted local aid since FY 2008. PILOT aid is funded at \$500 K less than FY 2014 at \$26.3 M.

Other Budgetary Transfers

| FY 2014 Estimated Spending vs. FY 2015 House 2 | | | | |
|---|----------------------------|-----------------------|------------------------|--------------|
| Other Budgetary Transfers | FY 2014 Estimated Spending | FY 2015 House 2 | Annual Change | % Change |
| Transfers for Payments to Hospitals and Providers | \$ 661,474,470 | \$ 622,261,307 | \$ (39,213,163) | -5.9% |
| Other Transfers to Non-Budgetary Funds | \$ 2,625,000 | \$ 9,653,272 | \$ 7,028,272 | 267.7% |
| Total Spending | \$ 664,099,470 | \$ 631,914,579 | \$ (32,184,891) | -4.8% |

Other budgetary transfers include payments to hospitals under the Delivery System Transformation Initiative Trust Fund (DSTI) and the Medical Assistance Trust Fund (MATF). Under the Governor's FY 2015 budget the DSTI program will provide two payments to hospitals in FY 2015, the second federal fiscal year (FFY) 2014 payment and the first FFY 2015 payment. The payments total \$235 M with the FFY 2015 payment receiving a 25% increase over FFY 2014, assuming sufficient budgetary resources. The increase will support additional hospital initiatives, consistent with MassHealth's 1115 Demonstration Waiver renewal application. The federal reimbursement revenue for the FY 2015 payments is \$118 M. The DSTI program is supported by a general fund transfer of \$210 M. The Medical Assistance Trust Fund receives \$412 M from the general fund to support \$584 M in payments to safety net hospitals and providers with high Medicaid volume. The sharp decline from FY 2014 is due to FY 2014 including a large FY 2013 payment.

Lastly, the Governor's FY 2015 budget invests \$25 M in the Massachusetts Life Sciences Center (MLSC), an increase of \$5.5 M above FY 2014, by dedicating FY 2014 surplus to support the Center. This funding will enable MLSC to provide research grants and accelerator loans to researchers and early-stage companies, a direct investment in business expansion and job growth in this critical sector.

State Workforce

Chapter 29, Section 6 states that “The operating budget shall indicate the number of positions proposed to be authorized for each state agency or such other public instrumentality for the ensuing fiscal year, the number of positions for each state agency in the current and ensuing fiscal years and such other information as may be held to explain the anticipated results of the proposed expenditures”.

To address this requirement, the Governor’s budget recommendation includes budgeted Full Time Equivalency (FTE) counts summarized at the Government area level. Additional detail is included throughout the Budget Recommendations to indicate the employee level within specific departments.

Effect of the Budget on Personnel to Date

Annually, the Executive Office for Administration and Finance (A&F) provides FTE caps to the Executive Branch Departments, prioritizing hiring in areas where positions are critical for public health and safety or where a position results in additional revenue or cost savings for the Commonwealth. FTE caps are implemented at the department level and reviewed regularly by A&F budget analysts to ensure agencies are taking the necessary steps to live within capped levels. It is important to note that FTEs correspond to budgeted level of staffing during any given fiscal year. For a number of reasons, particularly timing of planned hire dates, actual state employee head count and the number of budgeted FTEs may vary within state agencies. In addition, FTE counts typically are less than employee headcount or jobs, since a portion of state employees do not work full-time schedules.

Between the fall of 2008 and January 2013, the state workforce for jobs in the Executive Branch funded with operating dollars has declined by 3,942 jobs. The reduction can be attributed to layoffs, attrition and retirement across all agencies in the Executive Branch. This trend has been mirrored in the Non-Executive Branch. After accounting for an increase of 2,770 positions in January 2010 corresponding to the transition of seven county sheriffs’ offices to state agencies, total non-Executive budgetary jobs have declined by over 1,870 jobs. When considering employees paid in both branches, from all funding sources, the total state FTEs have decreased by close to 5,000 since FY 2008 (please see FTE discussion in the FY 2013 Statutory Basis Financial Report prepared by the State Comptroller’s Office).

The following chart lists the latest snapshot information. It should be noted that roughly 1,270 transportation FTEs were shifted off-budget in the fall of 2009, while 2,770 sheriff employees were shifted on to the state budget in January 2010. These changes should be accounted for when making historical comparisons.

STANDARD WORKFORCE SUMMARY AND VARIANCE REPORT, PAY PERIOD ENDING: 01/11/14

| PAY PERIOD | BUDGET | NON-BUDG | TOTAL | VARIANCES | BUDGET | NON-BUDG | TOTAL |
|-----------------------------|--------|----------|--------|---|---|------------|--------|
| BENCHMARK 1/20/2007 | | | | YTD FROM 1/20/2007 | | | |
| Executive Jobs | 38,742 | 6,138 | 44,880 | Exec Job Var | (3,130) | 3,081 | (49) |
| Non-Exec Jobs | 30,844 | 9,658 | 40,502 | Non-Exec Job Var | 1,742 | 4,578 | 6,320 |
| Totals | 69,586 | 15,796 | 85,382 | Totals | (1,388) | 7,659 | 6,271 |
| Executive FTE | 37,366 | 5,950 | 43,316 | Exec FTE Var | (2,678) | 3,138 | 460 |
| Non-Exec FTE | 30,079 | 8,616 | 38,695 | Non-Exec FTE Var | 1,708 | 1,819 | 3,527 |
| Totals | 67,445 | 14,566 | 82,011 | Totals | (970) | 4,957 | 3,988 |
| BENCHMARK 10/11/2008 | | | | YTD FROM 10/11/2008 | | | |
| Executive Jobs | 39,554 | 6,268 | 45,822 | Exec Job Var | (3,942) | 2,951 | (991) |
| Non-Exec Jobs | 31,741 | 9,895 | 41,636 | Non-Exec Job Var | 845 | 4,341 | 5,186 |
| Totals | 71,295 | 16,163 | 87,458 | Totals | (3,097) | 7,292 | 4,195 |
| Executive FTE | 38,308 | 6,119 | 44,427 | Exec FTE Var | (3,620) | 2,970 | (650) |
| Non-Exec FTE | 31,037 | 8,780 | 39,818 | Non-Exec FTE Var | 750 | 1,655 | 2,405 |
| Totals | 69,345 | 14,899 | 84,244 | Totals | (2,870) | 4,625 | 1,754 |
| PREVIOUS 12/28/2013 | | | | PREVIOUS V.S. CURRENT 12/28/2013 1/11/2014 | | | |
| Executive Jobs | 35,688 | 9,220 | 44,908 | Exec Job Var | (76) | (1) | (77) |
| Non-Exec Jobs | 32,641 | 14,287 | 46,928 | Non-Exec Job Var | (55) | (51) | (106) |
| Totals | 68,329 | 23,507 | 91,836 | Totals | (131) | (52) | (183) |
| Executive FTE | 34,761 | 9,089 | 43,850 | Exec FTE Var | (73) | (0) | (73) |
| Non-Exec FTE | 31,806 | 10,419 | 42,225 | Non-Exec FTE Var | (19) | 16 | (3) |
| Totals | 66,567 | 19,508 | 86,075 | Totals | (92) | 16 | (76) |
| CURRENT 1/11/2014 | | | | BENCHMARK V.S. CURRENT EXEC BUDGETARY JOBS | | | |
| Executive Jobs | 35,612 | 9,219 | 44,831 | | Benchmark | 10/11/2008 | 39,554 |
| Non-Exec Jobs | 32,586 | 14,236 | 46,822 | | Current | 1/11/2014 | 35,612 |
| Totals | 68,198 | 23,455 | 91,653 | | Actual Variance NOT adjusted (3,942) | | |
| Executive FTE | 34,688 | 9,089 | 43,776 | | Variance adjusted for MassDOT reform (2,673) | | |
| Non-Exec FTE | 31,787 | 10,435 | 42,222 | | | | |
| Totals | 66,475 | 19,524 | 85,999 | | | | |

Definitions:

| | |
|----------------------------|---|
| Standard Workforce: | Describes the set of employees who are likely working regularly. It excludes those on unpaid leave and those in contractor, board member and seasonal positions. |
| FTE: | "Full-Time Equivalent". Measures the workforce based on the hours each job is scheduled to work (not on hours actually worked per job). For example, two employees each scheduled as half-time (0.5) count as two jobs ("employees"), but only one FTE. |
| Jobs: | Actual people ("employees") on the pay period, also known as "head count". It is a measure of workforce counting the actual number of employees filling positions. |
| Budgetary: | Positions funded by the operating budget through direct appropriation and retained revenue accounts (i.e., GAA) based on the default account number in HRCMS. |
| Non-Budgetary: | Positions funded by sources other than the state's operating budget (federal, trust, grant and capital) |
| Executive: | Positions assigned to agencies in the Executive Branch, where the Governor is the Chief Executive Officer. |
| Non-Executive: | Positions assigned to agencies not within the Executive Branch. These include Legislative, Judiciary, Independents and the colleges and UMass in Education. |

House 2 Employment Levels

In reviewing the funding levels available to them for FY 2015, agencies must critically evaluate their employee level and determine further reductions are necessary to maintain a balanced budget. The Governor's FY 2015 budget recommendation projects a total of 67,202 budgetary FTEs. This amount includes FTEs from both Executive and Non-Executive departments as well as positions funded from the operating accounts listed within the budget. It should be noted that these figures are subject to change, based on various factors including final FY 2015 funding levels, actual payroll spending experience and budgetary guidance issued by A&F during FY 2015 spending plans (July/August 2014).

| | Current Year FY 2014 | Proposed FY 2015 | Annual Change |
|--|----------------------|------------------|---------------|
| Executive Branch Secretariats | | | |
| Administration and Finance | 2,831 | 2,862 | 31 |
| Education | 549 | 552 | 3 |
| Energy and Environmental Affairs | 1,969 | 1,976 | 7 |
| Housing and Economic Development | 714 | 728 | 14 |
| Health and Human Services | 19,969 | 19,906 | (63) |
| Labor and Workforce Development | 249 | 241 | (8) |
| Public Safety | 8,817 | 8,717 | (100) |
| Transportation | - | - | - |
| Sub-Total | 35,098 | 34,982 | (116) |
| | | | |
| Non-Executive Branch | | | |
| Judiciary | 7,283 | 7,316 | 33 |
| Legislature | 946 | 946 | - |
| Constitutional Officers and Independents | 9,801 | 9,881 | 80 |
| Higher Education Campuses | 14,078 | 14,077 | (1) |
| Sub-Total | 32,108 | 32,220 | 112 |
| | | | |
| TOTAL STATE BUDGETED FTEs | 67,206 | 67,202 | (4) |

Workforce Planning Goals

The Executive Office for Administration and Finance (A&F) and the Human Resources Division have worked together to implement clear policies surrounding employees. Each fall, A&F engages agencies in a spending plan process in which each account is evaluated to determine how funds will be spent for the current fiscal year. This requires a detailed description of employees for the current year - including those currently on staff, positions that are open and intended to be filled and new positions for which funding is available. The goals of the employee caps are to:

- **Restrain Growth in State Employee Levels:** Since payroll is a large portion of many agency expenditures, and reductions in force can take so long that savings cannot be realized in a fiscal year, caps are needed to manage hiring within available funding levels. Although some hiring may have small costs for the current year, the full-year value of new staff have budget impacts that should be considered.
- **Mitigate Shifts to Other Funding Sources:** Employees come onto the state payroll several ways including the operating budget (FTEs and contractors), the capital budget, federal grants and trusts. All sources are carefully reviewed to ensure we are maintaining compliance with employment laws and also to ensure that we are not using one time sources to pay for ongoing costs.
- **Manage Overtime Costs:** Although hiring restrictions are important, overtime costs must be considered to ensure that proper staffing levels are maintained for public health and safety where responsibilities are 24 hours, 7 days per week. Oftentimes, the savings of FTE restrictions are simply shifted to higher overtime. Therefore, prudent management of both overtime and staffing levels must be evaluated.

